

# Inspector General

United States  
Department *of* Defense



## **Monitoring of the Quality of the Defense Contract Audit Agency FY 2010 Audits**

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE <b>07 MAR 2013</b>		2. REPORT TYPE		3. DATES COVERED <b>00-00-2013 to 00-00-2013</b>	
4. TITLE AND SUBTITLE <b>Monitoring of the Quality of the Defense Contract Audit Agency FY 2010 Audits</b>				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>Department of Defense Inspector General, 4800 Mark Center Drive, Alexandria, VA, 22350-1500</b>				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT <b>Same as Report (SAR)</b>	18. NUMBER OF PAGES <b>100</b>	19a. NAME OF RESPONSIBLE PERSON
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>			

## Additional Copies

To obtain additional copies of the final report, visit [www.dodig.mil/audit/reports](http://www.dodig.mil/audit/reports) or contact the Office of the Assistant Inspector General for Audit Policy and Oversight at (703) 604-8760 or fax (571) 372-7454.

## Suggestions for Reviews

To suggest or request reviews, contact the Office of the Assistant Inspector General for Audit Policy and Oversight by phone (703) 604-8760 (DSN 664-8760), by fax (571) 372-7454, or by mail:

Department of Defense Inspector General  
OAIG-Audit Policy and Oversight  
ATTN: APO, Suite 11D28  
4800 Mark Center Drive  
Alexandria, VA 22350-1500



## Acronyms and Abbreviations

AICPA	American Institute of Certified Public Accountants
CAM	Contract Audit Manual
CIGIE	Council of the Inspectors General on Integrity and Efficiency
DCAA	Defense Contract Audit Agency
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
IG	Inspector General
MRD	Memorandum for Regional Directors



**INSPECTOR GENERAL**  
**DEPARTMENT OF DEFENSE**  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

March 7, 2013

**MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY**

**SUBJECT: Monitoring of the Quality of the Defense Contract Audit Agency FY 2010 Audits  
(Report No. DODIG-2013-044)**

We are providing this report for review and comment. The completion of this report was delayed due to a shift in our primary oversight of DCAA to reviewing Defense Hotline complaints during the period of January 2010 through January 2012.

We found that the Defense Contract Audit Agency (DCAA) did not exercise professional judgment in performing 37 (74 percent) of the 50 FY 2010 assignments reviewed. DCAA performed much of the field work on the reviewed assignments prior to FY 2010 and since FY 2009 has taken various corrective actions to address deficiencies identified in our review. This report acknowledges DCAA corrective actions and includes additional recommendations intended to improve audit quality. We will evaluate the effectiveness of DCAA corrective actions in the future. Additionally, we will evaluate the current DCAA system of quality control for audits as a part of our upcoming peer review.

We considered management comments on a draft of this report when preparing the final report. Comments provided by DCAA were partially responsive. DoD Directive 7650.3 requires that recommendations be resolved promptly. We request that DCAA provide additional comments for Recommendations 9.b, 11.a, 11.b, 11.c, 13, 16, and 17. We should receive the comments by April 5, 2013.

If possible, send an Adobe Acrobat pdf file containing your comments to either e-mail address provided below. Copies of your comments must have the actual signature of the authorizing official for your organization. We are unable to accept the /Signed/ symbol in place of the actual signature.

We appreciate the courtesies extended to the staff. Please direct questions to me or Carolyn R. Davis at (703) 604-8877 (DSN 664-8877), Carolyn.Davis@dodig.mil or Ms. Diane H. Stetler at (703) 604-8737 (DSN 664-8737), Diane.Stetler@dodig.mil. If you desire, we will provide a formal briefing on the results.

A handwritten signature in black ink, appearing to read "R. Stone", is written over a horizontal line.

Randolph R. Stone  
Deputy Inspector General  
Policy and Oversight





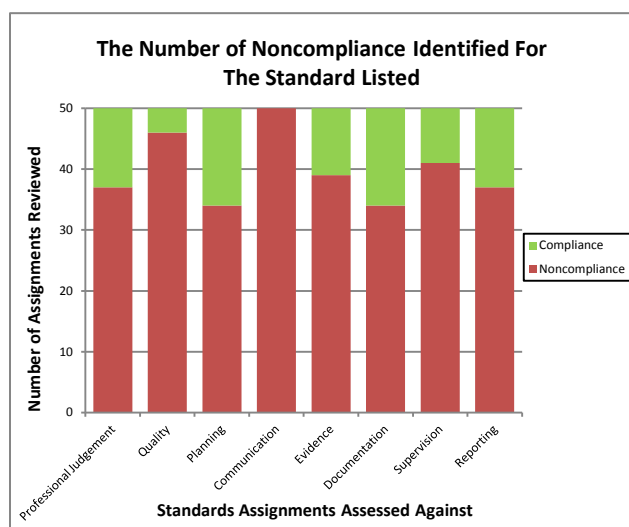
# Results in Brief: Monitoring of the Quality of the Defense Contract Audit Agency FY 2010 Audits

## What We Did

We performed quality assurance reviews on 50 Defense Contract Audit Agency (DCAA) reports issued during the first half of FY 2010. We evaluated assignments from all five DCAA regions and the Field Detachment to determine compliance with government auditing standards and DCAA policies and procedures. The completion of this report was substantially delayed due to the shift in our primary oversight of DCAA from reviews of audit quality to the review of hotlines during the period January 2010 through January 2012.

## What We Found

DCAA did not exercise professional judgment in performing 37 (74 percent) of the 50 FY 2010 assignments reviewed. DCAA performed much of the field work on the reviewed assignments prior to FY 2010. The abundance of non-compliances with standards identified in the 37 assignments evidenced the need for improvements in the area of competence at DCAA.



Significant quality issues identified included external impairments to independence, inadequate planning, poor communications with the requester and contractor, insufficient evidence, unsupported or untimely reports, poor documentation, and ineffective supervision and quality control. DCAA stated that the reviewed assignments could still evidence the residual effects of the production-oriented environment that previously existed. Since FY 2009, DCAA has taken various corrective actions such as revising training class curriculums, requiring additional training for all audit staff, and revamping audit programs and guidance. We will evaluate the effectiveness of these actions during future reviews.

## What We Recommend

We recommend that DCAA consider rescinding or supplementing certain reports, and taking other appropriate actions on the 37 assignments. We also recommend that DCAA reassess various policies, procedures, and training and revise them, as appropriate, to improve audit quality and compliance with government auditing standards.

## Management Comments and Our Response

DCAA management comments were generally responsive. DCAA considers corrective actions completed on 17 recommendations. Based on management comments, we deleted draft Recommendation 4 and revised draft Recommendation 12.a, now 11.a. We also clarified three findings. We request that DCAA provide additional comments on 7 recommendations. Please see the recommendations table on the back of this page.

## Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Contract Audit Agency	9.b, 11.a, 11.b, 11.c, 13, 16, 17	1.a, 1.b, 1.c, 2, 3, 4.a, 4.b, 4.c, 5, 6, 7, 8, 9.a, 9.c, 10, 11.d, 12.a, 12.b, 12.c, 14, 15

**Please provide comments by April 5, 2013.**

# Table of Contents

## Introduction

Objectives	1
Background	1

## General Standards

Professional Judgment	5
Independence	8
Competence	13
Quality Control and Assurance	17

## Examination Engagements

Planning	26
Auditor Communication During Planning	33
Evidence	37
Documentation	43
Fraud, Illegal Acts, Violations of Provisions of Contracts or Abuse	45
Supervision	51
Reporting	53

## Agreed-Upon Procedures Engagements 60

## Performance Audit 67

## Appendices

A. Scope and Methodology	71
B. Summary of Deficiencies Identified With Government Auditing Standards by Individual Assignment	74

## Management Comments 78

# Introduction

## Objectives

We conducted this review to determine whether attestation engagements<sup>1</sup> and performance audits<sup>2</sup> performed by the Defense Contract Audit Agency (DCAA) in FY 2010 complied with generally accepted government auditing standards (GAGAS), applicable DoD policies, and DCAA policies and procedures. We reviewed 47 examination engagements, 2 agreed-upon procedures engagements, and 1 performance audit. This amounts to a total of 50, with reports issued from October 1, 2009 through March 31, 2010. We will use the review results of FY 2010 assignments<sup>3</sup> as a baseline to measure future improvements in DCAA audit<sup>4</sup> quality. See Appendix A for a discussion of our scope and methodology.

## Background

### *Defense Contract Audit Agency*

**DCAA Charter.** In 1965, DCAA was formed to provide a single contract audit capability within the Department of Defense. DoD Directive 5105.36, “Defense Contract Audit Agency,” provides the mission, organization and management, responsibilities and functions, relationships, and authorities of DCAA. DCAA is a Defense agency under the direction, authority, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The primary mission of DCAA is to perform contract audits for DoD. DCAA also provides accounting and financial advisory services regarding contracts and subcontracts to DoD Components responsible for procurement and contract administration. In addition, DCAA performs contract audit services for non-DoD Federal organizations on a reimbursable basis, as appropriate. DCAA performs the majority of its work (88.25 percent of hours charged to assignments performed under GAGAS) as

---

<sup>1</sup> Attestation engagement is one of the three categories that the Comptroller General of the United States-issued generally accepted government auditing standards requirements apply to. Attestation engagements can cover a broad range of financial or nonfinancial objectives and may provide different levels of assurance about the subject matter or an assertion depending on the user’s needs. Attestation engagements result in an examination, a review, or an agreed-upon procedures report on a subject matter or on an assertion about a subject matter that is the responsibility of another party.

<sup>2</sup> Performance audit is another of the three categories that the generally accepted government auditing standard requirements apply to. GAGAS 1.25 defines performance audits as “...engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices.”

<sup>3</sup> The term ‘audit assignment’ is defined by DCAA as “... the authorization to perform a particular phase or aspect of the contract audit responsibility at a specific contractor.” DCAA establishes assignment numbers in its management information system to track individual projects being performed by the audit staff.

<sup>4</sup> DCAA uses the term ‘audit’ to refer to individual assignments and considers it as referring to a variety of types of evaluations of various types of data by a person other than the preparer of the data. To improve report readability, this report uses the term ‘audit’ to refer to an examination engagement when discussing the quality of work performed under GAGAS.



examination<sup>5</sup> engagements. DCAA also conducts some agreed-upon procedures<sup>6</sup> engagements and a limited number of performance audits that are conducted as operations audits. In FY 2010, DCAA issued 11,610 reports covering \$228 billion. Additional information on DCAA work is provided in Table 1 below.

**Table 1. FY 2010 DCAA Statistics**

<b>Type of Assignment</b>	<b>Number of Reports</b>	<b>Dollars Examined (000s)</b>	<b>Questioned Costs (000s)</b>	<b>Hours Charged</b>
Operations Audits	25	\$0	\$325,025	25,479
Incurred Cost	1,634	33,459,535	137,685	806,388
Internal Controls	533	0	0	187,366
Special Audits	3,112	8,147,334	832,011	688,960
Cost Accounting Standards	916	946,270	40,419	254,788
Forward Pricing	5,331	185,060,882	12,267,786	1,325,704
Defective Pricing	59	0	53,747	38,009
<b>Totals</b>	<b>11,610</b>	<b>\$227,614,021</b>	<b>\$13,656,673</b>	<b>3,326,694</b>

**DCAA Organization and Functions.** In FY 2012, DCAA had approximately 4,725 employees located in 116 field offices throughout the United States, Europe, the Pacific, and Southwest Asia. DCAA consists of headquarters, five regions, and Field Detachment (for classified audits). Regional directors are responsible for planning, managing, and accomplishing the DCAA mission in assigned geographical areas, including personnel and resources in the individual regional offices and various field audit offices within their region. The Field Detachment director has the same responsibility for worldwide DCAA contract audits of compartmented programs and the personnel and resources assigned to Field Detachment. DCAA audits forward pricing proposals submitted by contractors and subcontractors in connection with award, administration, modification, or re-pricing of Government contracts.<sup>7</sup> DCAA audits also help contracting officers determine the adequacy of a contractor's estimating, budgeting, billing, and accounting systems. In addition, DCAA audits for compliance with cost accounting standards and disclosed accounting practices; and allowability of incurred costs charged to the Government in accordance with the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement.

---

<sup>5</sup> An examination engagement or examination provides positive assurance. GAGAS 1.23a states that an examination "...[c]onsists of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria."

<sup>6</sup> GAGAS 1.23c states that an agreed-upon procedures engagement or agreed-upon procedures "...[c]onsists of specific procedures performed on a subject matter."

<sup>7</sup> Forward pricing proposals assignments are audits of estimated future costs of proposed contractor pricing, proposed contract change orders, costs for re-determinable fixed-price contracts, and costs incurred but not yet covered by definitized contracts.

## ***Generally Accepted Government Auditing Standards***

DoD Instruction 7600.02 dated April 27, 2007, “Audit Policies,” requires that all independent audit and attestation engagements of DoD organizations, programs, activities, and functions be conducted in accordance with GAGAS as issued by the Comptroller General of the United States. GAGAS provides the framework for auditors to perform high-quality audit work with competence, integrity, objectivity, and independence. The standards require auditors to exercise professional judgment in planning and performing audits and attestation engagements, and in reporting the results. GAGAS includes ethical principles; general standards; field work and reporting Standards for Financial Audits; General, Field Work, and Reporting Standards for Attestation Engagements; and Field Work and Reporting Standards for Performance Audits sections. For attestation engagements, GAGAS incorporates the American Institute of Certified Public Accountants (AICPA) general standard on criteria, the field work and reporting standards, and related Statements on Standards for Attestation Engagements [SSAE] unless specifically excluded or modified.<sup>8</sup> GAGAS also establishes additional field work and reporting standards for attestation engagements.

## ***GAGAS-Required Peer Review***

Since August 26, 2009, DCAA has not had an opinion on its quality control system covering DCAA audits and attestation engagements as required by GAGAS 3.59b. GAGAS 3.50b and 3.55 require audit organizations performing audits or attestation engagements in compliance with GAGAS to have an external peer review at least once every 3 years. Based on the criteria, DCAA should have obtained a peer review on its work performed in FY 2009.

We performed the last peer review on DCAA audit and attestation engagement reports issued in FY 2006. We issued Report No. D-2007-6-006, “Review of the Defense Contract Audit Agency Quality Control System,” on May 1, 2007. We concluded that the DCAA system of quality control used on audits and attestation engagements for the review period ended September 30, 2006, was adequate. The report identified several concerns or areas that DCAA needed to improve in to comply with GAGAS while conducting engagements.

- Incurred cost desk reviews should not have been performed as review engagements.<sup>9</sup>
- Contract audit closing statement assignments performed using standard programs did not gather sufficient evidence to meet the GAGAS requirements for examination engagements.

---

<sup>8</sup> The 2007 revision to GAGAS, did not exclude any field work standards, reporting standards, or Statements on Standards for Attestation Engagements.

<sup>9</sup> GAGAS 1.23b states that review engagements consist of sufficient testing to express a conclusion about whether any information came to the auditors’ attention based on the work performed that indicates the subject matter is not based on (or not in conformity with) the criteria or the assertion is not presented fairly (or not stated fairly) in all material aspects based on the criteria. This is also known as providing negative assurance.

- Agreed-upon procedures engagements did not comply with applicable standards regarding requester responsibility for procedures; proper definition of criteria; appropriate definition of procedures; and reporting requirements.
- Specific criteria used in the working papers or in the associated report were not properly identified.
- Steps were not designed to provide reasonable assurance of detecting fraud, illegal acts, or violations of contract provisions.
- Sampling plans for nonstatistical and statistical samples were not adequately documented.
- DCAA reports did not fully disclose or describe the use of statistical or nonstatistical sampling plans.

The report also informed DCAA that continued and repeated noncompliances identified during its internal quality assurance reviews could indicate significant deficiencies in the DCAA quality control system and could negatively impact the overall peer review opinion in future peer reviews.

On August 24, 2009, we notified DCAA that our opinion would no longer apply to the DCAA system of quality control. This action resulted from our significant findings described above coupled with the results of the July 2009 Government Accountability Office (GAO) draft report, “DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform” (GAO-09-468). After August 26, 2009, all DCAA reports identified as being in compliance with GAGAS should have contained a modified GAGAS statement noting an exception to compliance with the Quality Control and Assurance standard until a new DCAA peer review report is issued.

In FY 2012, with the assistance of the Council of Inspectors General on Integrity and Efficiency (CIGIE) Audit Committee, DCAA started the process of obtaining an outside firm to perform its next peer review. DCAA stated that the peer review is to be performed in FY 2013 and cover reports issued in FY 2012.

### ***Impact of DCAA Corrective Actions from Prior Reviews on Reviewed FY 2010 Assignments***

Prior GAO and DOD Inspector General (IG) reviews of DCAA reports identified significant deficiencies in audit work, including poor supervision, inadequate documentation, inappropriate changes to report opinions, and lack of sufficient testing to support report opinions. To address audit quality issues, DCAA implemented various corrective actions such as revised supervisory training; a required computer-based training course on working paper documentation; required training on GAGAS; revamped audit programs; and issuance of revised guidance on variable and attribute sampling with relevant training modules. DCAA had not completed all of its planned corrective actions in time to impact work performed prior to FY 2009. DCAA performed most of the field work on the engagements we reviewed prior to FY 2009 even though DCAA issued the reports in FY 2010.

## ***DOD IG Continuous Monitoring of DCAA Audit Activities***

The Inspector General Act of 1978, as amended, Sections 4(a)(1) and 8(c)(6), direct the DOD IG to develop policy, evaluate program performance, and monitor and evaluate DoD auditor compliance with internal audit, contract audit, and internal review principles, policies, and procedures. To carry out these responsibilities on DCAA audit activities, the Office of the Assistant Inspector General for Audit Policy and Oversight performs oversight reviews of high-risk DCAA audit areas and quality assurance evaluations of DCAA attestation engagements and audits. We also conduct various ongoing activities covering DCAA that include monitoring:

- training,
- implementation of agreed-to corrective actions,
- draft or final contract audit policy issuances,
- results from DCAA internal quality assurance reviews, and
- results of DCAA internal review directorate evaluations.

## **General Standards**

### **Professional Judgment**

#### ***Failure to Exercise Sufficient Professional Judgment***

In 37 of the 50 assignments (74 percent) reviewed, the audit staff<sup>10</sup> did not exercise professional judgment as evidenced by deficiencies identified in multiple standards areas. The 37 assignments had a high number of deficiencies, ranging from 6 to 9 deficiencies out of 9 standards areas excluding professional judgment. Table 2 summarizes the deficiencies identified by each region and Field Detachment. Appendix B summarizes the results by individual assignment. Both tables and the following report sections on individual standards demonstrate a pattern of noncompliance spread among all regions and Field Detachment, and among all engagement types.

---

<sup>10</sup> Audit staff includes all DCAA employees categorized in the Government 0511 Auditor job series and, for purposes of this report section, includes auditors assigned to the audit office, supervisory auditors, audit office managers, auditors assigned to regions and headquarters, and regional or detachment audit managers who worked on the reviewed assignments.

**Table 2. Number of Noncompliances Identified by Region or Field Detachment for Each Overall Standard Assessed**

<b>Standard</b>	<b>Central Region</b>	<b>Eastern Region</b>	<b>Northeastern Region</b>	<b>Mid-Atlantic Region</b>	<b>Western Region</b>	<b>Field Detachment</b>	<b>Total No. Assignments Not Meeting Standards</b>
Professional Judgment	5	5	8	7	8	4	<b>37</b>
Independence	1	2	-	2	-	-	<b>5</b>
Competence	-	-	-	1	2	2	<b>5</b>
Quality	7	8	9	8	9	5	<b>46</b>
Planning	6	5	6	6	7	4	<b>34</b>
Communication	9	9	9	9	9	5	<b>50</b>
Evidence	6	5	8	8	8	4	<b>39</b>
Documentation	5	5	7	6	7	4	<b>34</b>
Supervision	6	6	8	8	9	4	<b>41</b>
Reporting	5	5	8	7	8	4	<b>37</b>

Our review results indicate a higher rate of noncompliance with professional judgment standards than the FY 2010 DCAA internal quality assurance directorate’s review results of 50 percent of assignments not demonstrating professional judgment. Additional information on the DCAA internal quality assurance review results is included in the ‘Quality’ section of this report.

## **Recommendations, Management Comments, and Our Response**

**We recommend that the Director, Defense Contract Audit Agency:**

- 1. Direct each audit office to take the headquarters-determined corrective action(s) for assignments listed in Appendix B as not demonstrating professional judgment. Corrective actions might include:**
  - a. Rescinding the reports and notifying those who received the reports not to rely on them or performing additional work and supplementing the original report, whichever action is most appropriate depending on how contracting officers are using or relying on the report or information in the report.**

## **DCAA Comments**

DCAA agreed in principle stating that after obtaining additional information from DOD IG on the noncompliances with GAGAS, DCAA would assess the circumstances for the reports not demonstrating professional judgment and determine the appropriate actions in each circumstance by June 30, 2013.

- b. Inserting into the engagement or audit documentation file a memorandum stating that the engagement or audit did not comply with government auditing standards, the work should not be relied on for other engagements or audits, and the assignment should not be used as an example to perform other engagements or audits.**

## **DCAA Comments**

DCAA agreed stating that DCAA would include a memorandum in the audit file for those assignments not demonstrating professional judgment by December 31, 2012.

- c. Reviewing the deficiencies identified in the various assignments and taking appropriate corrective actions regarding the audit staff involved to include additional training when warranted.**

## **DCAA Comments**

DCAA agreed in principle stating that since FY 2009, DCAA has taken actions to improve audit quality and reduce noncompliances. For instance, all audit staff, including those involved in the assignments not demonstrating professional judgment, received extensive training to promote compliance with GAGAS. DCAA also stated that it will continue to provide additional training with emphasis on improving audit quality. DCAA considers actions already taken related to this recommendation to be complete.

## **Our Response**

DCAA comments were responsive. No additional comments are needed.

- 2. Re-emphasize the importance of compliance with government auditing standards and applicable Defense Contract Audit Agency policies and procedures through issuance of alerts or other appropriate memorandums detailing the various deficiencies identified, causes, and corrective actions to be taken by all audit offices.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that since FY 2009, DCAA took, and will continue to take, significant steps to improve audit quality including issuing a significant number of guidance memorandums and providing extensive training. DCAA listed various completed and in-process efforts, which included various training initiatives, workshops and conferences, and guidance memorandums or audit alerts on recurring issues found during quality assurance reviews, sampling policy, contractor notification letters, performing sufficient testing, and denial of access to records. DCAA considers actions taken in response to this recommendation to be complete.

## **Our Response**

DCAA comments were responsive. No additional comments are required.

## **Independence**

### ***Independence Questioned***

GAGAS 3.03 and 3.10 require the auditor and the audit organization to be free from personal, external, and organizational impairments to independence, and to avoid the appearance of such impairments. We identified issues with independence in fact or appearance on an external level in 4 of the 50 assignments reviewed. We also identified an impairment on one assignment caused by undue influence resulting in failure to exercise professional judgment. For an additional four assignments, we were unable to determine whether a personal impairment existed because DCAA did not provide the detailed information identifying the specific personal impairments submitted by six auditors who worked on the four assignments. Also, in one assignment, a DCAA audit office's verbal agreement with a contractor could result in restricted access to a document needed for another DCAA engagement.

### ***External Impairments Identified***

External impairments in fact or appearance existed in four of the assignments reviewed. GAGAS 3.10 requires audit organizations to be free from external impairments to independence. Factors external to the audit organization may restrict the work or interfere with the auditors' ability to form independent and objective opinions, findings, and conclusions.

- For Assignment Number 1721-2009B14980001, the supervisory auditor allowed the contractor to improperly influence the examination engagement. This engagement involved the review of a contractor's indirect and other direct cost internal control system, which processed \$708 million in FY 2007. The supervisor told the senior auditor and technical specialist to supersede working papers documenting unallowable travel cost identified during a review of the travel expense reports because the contractor complained. The contractor objected to DCAA citing a deficiency because the travel costs had not yet gone through the contractor's review process for unallowable costs prior to certification of its incurred cost submission. DCAA should have still cited the contractor for an internal control deficiency because controls should exist in the travel system to screen out the majority of unallowable costs. The contractor should not rely on its screening process prior to certifying its incurred cost submission as the primary internal control against claiming unallowable costs. Failure to address the deficiency resulted in the contractor potentially billing unallowable costs on progress payments or using unallowable costs as a basis for proposals. Documentation of the supervisory auditor's decision to supersede the working papers did not include information regarding the contractor's objection.



Decisions of this importance based, in whole or part, on contractor verbal or written objections or additional information provided must be properly documented in the working papers.

- In a pre-award accounting system examination engagement of a small contractor with \$510,000 in sales, Assignment Number 6431-2009B17740013, the contractor attempted to control what the auditor reviewed by providing inaccurate or incomplete information and, therefore, restricted the work. The contractor stated that DCAA had performed an accounting system review in 2006. However, DCAA was unable to locate that assignment or any evidence that the assignment was requested, scheduled, or performed. When requested to provide information on its Government contracts, the contractor never listed its subcontracts on the U.S. Navy and Department of Homeland Security contracts. The auditor never independently verified the contractor's sales nor its contracts or subcontracts even though this information would be used to select vouchers for review in the engagement. In accepting the contractor's sales and contract information without independent verification, the auditor did not consider that the contractor previously provided the auditor inaccurate information by erroneously telling the auditor that DCAA had already performed an accounting system review. Using incomplete information, the auditor selected a less representative project, a grant, to trace costs through the contractor's accounting system. The auditor allowed the contractor to improperly influence the engagement scope resulting in an impairment to independence. GAGAS 3.10b describes an external impairment as including situations where external interference with the selection or application of audit procedures or in the selection of transactions to be examined occurs.
- During a control environment internal control system examination engagement<sup>11</sup> of a contractor with FY 2009 sales of \$674.4 million, Assignment Number 3311-2008C11070001, the contractor redacted information on 80 out of 85 contractor internal hotline cases, rendering the information useless to the auditor. The auditor required the redacted information in the internal hotline case reports to perform procedures key to the engagement objectives. GAGAS 3.10d describes an external impairment as situations where an externally imposed restriction on access to records occurs. Without access to all the information regarding the internal hotline cases, the auditor is unable to evaluate the thoroughness of the

---

<sup>11</sup> The control environment sets the tone of an organization and influences the way a contractor structures its business activities, sets its objectives, and assesses its risks. A review of the control environment evaluates key components such as integrity and ethical values, organization structure, assignment of authority and responsibility, human resources policies and procedures, management philosophy and operating style, and board of directors or audit committee participation. Integrity and ethical values includes a contractor's business ethics and its compliance or self-governance program. Contractor internal hotline reviews or inquiries are part of its compliance program.

contractor's internal reviews and any corrective actions taken. This step is key to determining whether the contractor's ethics program is operating effectively and in compliance with Government acquisition regulations.<sup>12</sup>

- During the examination engagement of \$1.2 million charged to a Mentor Protégé contract, Assignment Number 1661-2009H17900002, the auditor sent the draft report to the requester to provide comments on: (i) the DCAA interpretation of the Mentor Protégé Program guidance used to identify questioned costs; (ii) areas in the report requiring additional information; and (iii) the content and format of the report. DCAA auditors routinely check with the requester or other contracting officials to obtain information on contract terms or other criteria used in the engagement. However, the auditor must be careful that DCAA makes the final decision regarding how the criteria are interpreted and applied during the engagement and in the report. GAGAS 3.10g describes an external impairment as situations where an external party inappropriately influences the auditor's judgment as to the appropriate content of the report. When the DCAA audit staff asked the requester to comment on the DCAA interpretation of the Program guidance as criteria for identifying questioned costs, the audit staff provided the requester the opportunity to inappropriately influence the report findings and content. This created the appearance of an external impairment.

### ***External Impairment Possible Due to Audit Office Decision***

During a budget and planning system examination engagement, Assignment Number 4301-2009H11020002, the contractor limited access to its long range strategic plans by granting only one DCAA auditor access to the document. The DCAA audit office conducting the review believed that agreeing to the contractor's access restrictions did not negatively impact its review or cause an impairment to independence. However, the contractor representative stated during discussions that the contractor wanted to restrict all DCAA access to the document, not just access for this particular assignment, to one auditor. DCAA guidance instructs the audit office not to enter into written agreements with contractors on access to records procedures. Audit offices are also to notify, in writing, a contractor when its documents containing policies or procedures for DCAA access to records will impede the audit process. DCAA guidance does not address situations where more than one audit office may require access to the same information. Verbal access to records agreements should be coordinated with the DCAA audit office cognizant of the corporate office to ensure that other audit offices' access is not negatively impacted. By not formally notifying the contractor that the agreement only applied to this engagement, the audit office caused a potential access issue and independence impairment in general.

---

<sup>12</sup> This assignment is also discussed in the Systemic Issue with Insufficient Evidence in Internal Control System Reviews section of this report which provides additional information regarding the Government acquisition regulation requirements for a contractor ethics program.

## ***Missing Recusal Letters***

For 6 of the 23 DCAA auditors who checked a box on the annual independence statements indicating that an exception to personal independence existed, DCAA did not provide the auditors' written explanations identifying the specific details on the impairment or situations where a personal impairment existed.<sup>13</sup> We were, therefore, unable to determine whether a personal impairment existed on four assignments reviewed. Four of the six missing exception or recusal documents explained exceptions noted on a then-current FY 2010 independence statement. DCAA policy requires the audit offices to maintain current independence statements in the personnel files kept by the first level supervisor. Therefore, these four missing written explanations should have been available and we could not verify whether the supervisor ever received details regarding the exceptions from the auditors or considered the exceptions as required. Additional information on deficiencies in the DCAA quality control procedure relating to independence is discussed in the Quality section of this report.

## ***Impairment Associated with Undue Influence from Financial Liaison Advisor Nonaudit Service***

In one assignment, we identified an impairment to independence created by another DCAA component that provided nonaudit services. GAGAS 3.03 states that an auditor and the audit organization must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties with knowledge of the relevant information. Auditors should avoid situations that could lead objective, knowledgeable third parties to conclude that auditors are not able to maintain independence and impartial judgment on all issues associated with conducting the audit and reporting on the work.

During the planning of Assignment Number 6211-2009C13500003, which was set up as a comprehensive labor examination engagement involving an offsite contractor location, the DCAA headquarters financial liaison advisor<sup>14</sup> unduly influenced the engagement scope. The audit staff assigned to perform the engagement is responsible for determining the appropriate engagement scope, after considering the engagement's objective and risk factors. Acceptance of the DCAA headquarters financial liaison advisor's opinion by the acting supervisor resulted in the audit staff not properly designing procedures to detect an identified fraud indicator – employees working less than 8-hours a day. The acting supervisor initially determined that a comprehensive labor audit, instead of a floor check,

---

<sup>13</sup> Organizations may refer to the written explanations regarding an impairment to independence as exception or recusal letters.

<sup>14</sup> The DCAA financial liaison advisor provides advisory audit services to DOD procurement and contract administration offices by providing onsite accounting and financial advice to contracting officers, negotiators, and buyers. Some financial liaison advisor duties and responsibilities include: facilitating effective communication and coordination between procurement officers and auditors and providing advice to the procurement office in connection with contractor's cost representations and related matters, in consultation with the cognizant DCAA audit office. DCAA financial liaison advisors report to and are supervised by a headquarters DCAA component. DCAA considers financial liaison advisory services to be a nonaudit service.

was needed to adequately address the requester's concern that contractor employees were not working full 8-hour days. The DCAA headquarters financial liaison advisor overstepped his position's assigned responsibilities when he disagreed with the acting supervisor's scope assessment in an e-mail pointing out how the objectives of a floor check would address the requester's needs. A main function of the DCAA headquarters financial liaison advisor is to facilitate effective communication and coordination between a requester and the audit staff assigned to perform the engagement. The DCAA headquarters financial liaison auditor did not properly perform this function when he did not explain to the requester the acting supervisor's concerns and need to expand the engagement scope. DCAA emphasizes to the audit offices the importance of meeting the requester's needs and audit offices place great importance on a financial liaison advisor's opinions concerning the appropriate engagement scope needed to satisfy the request. The DCAA headquarters emphasis on meeting the requester's needs combined with the fact that financial liaison advisors are part of a headquarters directorate, influenced the acting supervisor's decision on the appropriate scope even though the financial liaison advisor was not in the supervisor's management chain of command. In the end, the DCAA headquarters financial liaison advisor caused an impairment to independence by improperly influencing the acting supervisor causing her to compromise her professional judgment in planning and conducting the engagement

### ***Revised Finding and Deleted and Renumbered Recommendations***

We revised the draft finding related to an impairment associated with a nonaudit service, which was originally identified as an organizational impairment. Also, as a result of management comments, we deleted draft Recommendation 4 and renumbered the remaining recommendations accordingly. The Director, DCAA, stated that the existing guidance on denial of access to records was sufficient and he saw no benefit to revising guidance to address one particular instance. As part of our continuous monitoring responsibilities, we will monitor access to records issues to ascertain whether DCAA has any systemic issues related thereto.

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

- 3. Emphasize to the audit staff the importance of reporting and elevating all access to records issues following the established DCAA process and procedures.**

### **DCAA Comments**

DCAA agreed in principle. DCAA stated that DCAA included a presentation on access to records issues in the Training Initiative on Performing Quality Audits given between December 2010 and April 2011 and also revised the annual independence on-line CMTL

[Computer Managed Training Library] Course No. 9022 to emphasize the importance of following procedures for access to records issues in September 2010. In addition, DCAA stated that DCAA issued guidance on access to records issues dealing with attorney-client privilege or attorney-work-product doctrine assertions. DCAA considers actions taken to address this recommendation as complete.

## **Our Response**

DCAA comments were responsive. On September 20, 2012, DCAA provided us with CMTL Course No. 9022, Independence Training, which covers access to records issues. No additional comments are required.

## **Competence**

### ***Lack of Professional Judgment Evidenced by Significant GAGAS Noncompliances***

The abundance of noncompliances with standards identified in the 37 assignments evidences the need for improvements in the area of competence at DCAA. GAGAS 3.33 recognizes that competency and professional judgment are interrelated because judgments made are dependent on the auditors' competence. GAGAS 3.40 requires that the staff assigned to perform the audit or attestation engagement must collectively possess adequate professional competence for the tasks required. GAGAS 3.42 further emphasizes that competence enables an auditor to make sound professional judgments. Finally, GAGAS 3.45 requires auditors who perform attestation engagements to be knowledgeable about the applicable AICPA attestation standards and to be competent in applying them. The abundance of noncompliances with standards could have resulted from the need for improvements in education, training, experience, supervision, guidance, or skills.

In September 2008 and October 2009, Congress held hearings on the results of GAO and IG reviews of two Western region audit offices. Both GAO and the IG provided written products to DCAA on these issues before the hearings. In September 2008, DCAA revised its performance metrics eliminating metrics associated with set budgeted hours and the production culture previously emphasized by DCAA management. In December 2008, DCAA eliminated any language suggesting that the audit office consider programmed hours when establishing budgeted hours for an assignment.

Also, in September 2009, GAO emphasized the root cause of the DCAA audit failures was a production-oriented environment where the policies, procedures, and training focused on audit quantity instead of audit quality. DCAA performed much of the field work on the assignments we reviewed prior to September 2009 and the reports were issued from October 2009 through March 2010. DCAA stated that in FY 2010 DCAA was making substantial efforts to shift their policies, procedures, training, and culture from a focus on production to a focus on audit quality. Therefore, the reviewed assignments could still evidence the residual effects of the production-oriented environment. Our report includes recommendations for improvements needed in audit

quality, collective staff competence and organizational culture. These recommendations are in addition to or build on the corrective actions already taken by DCAA to improve the quality of its work and its work environment.

### ***Continuing Professional Education Requirements Met But Not Sufficient to Ensure Quality Work***

Compliance with the quantitative GAGAS requirements for continuing professional education did not result in DCAA auditors performing quality work in compliance with GAGAS. DCAA auditors consistently did not apply key auditing concepts required by professional standards as explained in the Professional Judgment; Planning; Evidence; Documentation; Fraud, Illegal Acts, Violations of Provisions of Contracts or Abuse; and Supervision sections of this report. The abundance of noncompliances identified by our review call into question the effectiveness of the DCAA training curriculum, including its delivery methods.

GAGAS 3.46 requires auditors performing work under GAGAS to obtain, every 2 years, the following continuing professional education:

- at least 24 hours directly related to government auditing, the government environment, or the specific or unique environment in which the audit organization operates;
- 56 additional hours that enhances the auditor's professional proficiency to perform audits or attestation engagements; and
- at least 20 hours in each year of the 2-year period.

Our review of DCAA compliance with continuing professional education requirements did not identify deficiencies in meeting the GAGAS requirements for a minimum number of continuing professional education hours in various general categories. We identified only a few instances where auditors did not take training specified as mandatory by DCAA management. The abundance of noncompliances with GAGAS identified in our review, however, indicates that the qualitative aspects of the DCAA training program need revamping.

As mentioned previously in this report, DCAA has taken corrective actions regarding the training provided to its audit staff to improve audit quality. However, DCAA management needs to accurately assess the audit staffs' skill needs as required by GAGAS 3.41 and to critically analyze the DCAA process for providing needed training, supervision, guidance, experience, and appropriate skills. DCAA should perform a thorough analysis of its course curriculum, taking into account any changes already made, to identify appropriate areas where the individual and collective competency of its staff needs to be enhanced. DCAA should also consider outside sources for core training in various areas including, but not limited to, government auditing standards, internal controls and related systems reviews, and AICPA attestation standards. Training from outside sources should enhance, not replace, DCAA-provided training. Training geared to more generalized audit environments or topics would complement DCAA-specific training by providing a stronger foundation for DCAA auditors to understand general

auditing and accounting concepts. In addition, DCAA should use a variety of delivery methods to increase the successful transfer of knowledge from the classroom to the actual audit environment. Finally, to increase the effectiveness of the various training methods, DCAA should consider increasing the amount of on-the-job training provided by experienced auditor-coaches from both outside and inside the organization.

### ***Inexperienced Auditors Inappropriately Assigned to Complex Engagements***

In 3 of the 50 assignments reviewed, auditors with limited experience or training were assigned to complex engagements. In two assignments,<sup>15</sup> the auditors either did not possess the knowledge and skills required or did not receive appropriate supervision reflective of their limited experience to adequately perform the assignment. In the other assignment,<sup>16</sup> increased supervisor and audit manager involvement made up for the lack of experience and training of the audit staff. GAGAS 3.33 discusses the interrelationship between professional judgment and competence because auditors' judgments are dependent upon the auditors' competence. GAGAS 3.36 further links the determination of whether professional judgment was demonstrated in an engagement to the appropriateness of the consideration of the collective experience, training, knowledge, skills, abilities, and overall understanding required by the audit team and its members to properly perform the engagement. Without the appropriate mix, the audit team will not be able to properly assess the risks that the subject matter under audit may contain a significant inaccuracy or could be misinterpreted. Therefore, DCAA used inexperienced auditors under limited supervision, which contributed directly to the audit teams not demonstrating professional judgment. DCAA use of inexperienced auditors and the associated lack of professional judgment also led to the noncompliances identified in the assignment with key standards such as planning, evidence, documentation, and reporting.<sup>17</sup> In addition, two of the three assignments were forward pricing examination engagements. One engagement was for a \$98.8 million firm-fixed-price proposal and the other engagement reviewed \$16.6 million in travel and other direct costs for a \$30.8 million cost-plus-fixed-fee proposal. GAO identified an issue with auditor trainees being inappropriately assigned to complex forward pricing audits.<sup>18</sup>

---

<sup>15</sup> The two assignments numbers are 6211-2009C13500003 and 9861-2009P21000019. Both were examination engagements.

<sup>16</sup> Assignment Number 9761-2009T2700040 was an examination engagement.

<sup>17</sup> GAGAS noncompliances identified for several standards led to an overall assessment of the assignments not meeting professional judgment. For details regarding the noncompliances, see the sections of this report that discuss each standard. Additionally, the schedule in Appendix B summarizes the overall noncompliances by individual assignment.

<sup>18</sup> The finding is described in Case 8 on page 22 of GAO Report No. GAO-08-857, "DCAA AUDITS: Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated," July 22, 2008.



# **Recommendations, Management Comments, and Our Response**

## **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

- 4. Improve the effectiveness of Defense Contract Audit Agency training by:**
  - a. Performing a comprehensive review and analysis of the Defense Contract Audit Agency continuing professional education training program, including course curriculum, content and delivery methods, to identify appropriate areas for enhancement of the individual and collective competency of its staff.**

## **DCAA Comments**

DCAA agreed in principle stating that DCAA integrated its training on GAGAS and AICPA standards into several training courses and reviewed all Defense Contract Audit Institute courses to ensure GAGAS requirements are addressed when applicable. The DCAA Advisory Council on Learning and Talent Development's review of the Defense Contract Audit Institute curriculum, delivery methods, and locations was to be finished by September 30, 2012. DCAA plans to determine which recommendations from this review should be implemented and take the appropriate actions at a date to be determined.

## **Our Response**

Management comments were responsive. No additional comments are required.

- b. Using outside sources for certain core training courses to supplement existing Defense Contract Audit Agency training courses in various areas, including but not limited to, government auditing standards, internal controls and related systems reviews, and American Institute of Certified Public Accountants attestation standards.**

## **DCAA Comments**

DCAA agreed in principle stating that the Defense Contract Audit Institute already uses external sources to assist in developing course content tailored for the contract audit environment and provided several examples. DCAA considers the action to address this recommendation complete. On September 19, 2012, DCAA stated that auditors are encouraged to take outside training and subsequently provided a list of external courses taken by auditors in FY 2012. DCAA further clarified that it did not want to designate external courses as "core" or required courses.

## **Our Response**

DCAA comments were responsive. No additional comments are required.

- c. **Performing an analysis for the implementation of a robust on-the-job coaching program to provide auditors and supervisors more hands-on training regarding proper application and interpretation of government auditing standards and related American Institute of Certified Public Accountants attestation standards.**

## **DCAA Comments**

DCAA agreed in principle. On August 1, 2012, DCAA announced a 3 to 4 month pilot coaching program of 100 nonbargaining unit employees. The objective of the coaching program is to assist less experienced auditors in improving their technical skills and performance. DCAA will deploy the coaching program agency-wide after incorporating feedback from the pilot test and after completing negotiations with the Union. DCAA considers the action taken to address this recommendation as complete.

## **Our Response**

DCAA comments were responsive. No additional comments are required.

## **Quality Control and Assurance**

### ***Aspects of DCAA Quality Control System Ineffective***

In 46 of the 50 assignments reviewed, the DCAA quality control system was ineffective in ensuring that its attestation engagement and performance audit assignments complied with applicable professional standards. GAGAS 3.50a requires that an audit organization performing work in accordance with government auditing standards, establish a quality control system designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements. GAGAS 3.35 provides that using professional judgment in all aspects of carrying out professional responsibilities, including maintaining appropriate quality control over the assignment process, is essential to performing and reporting on an engagement. The need for improvement in the DCAA quality control system was evidenced by the deficiencies identified in multiple standards areas; in engagements performed in all regions and Field Detachment; and in all engagement types reviewed. Numerous deficiencies are further explained in other sections of this report.

### ***DCAA Quality Assurance Program***

The DCAA headquarters Quality Assurance Directorate performs the GAGAS-required monitoring function as part of the overall DCAA quality control system as described in DCAA Instruction No. 7640.20, "DCAA Audit Quality Control and Assurance Program," dated March 11, 2011. In FY 2010, the DCAA Integrity and Quality Assurance Directorate reviewed 28 audit offices and 465 assignments. GAGAS 3.50 requires audit organizations to establish policies and procedures in its system of quality control to address: (1) audit and attestation engagement performance, documentation, and reporting; and (2) monitoring of quality. Monitoring is an ongoing, periodic assessment of audit

and attestation engagements designed to provide management of the audit organization with reasonable assurance that the policies and procedures related to the system of quality control are suitably designed and operating effectively in practice. Monitoring is most effective when performed by individuals who do not have responsibility for the specific activity being monitored. The DCAA internal quality assurance program is to cover GAGAS-covered audit work from approximately one-third of the DCAA audit offices in each year of a given 3-year period. The annual review plan is to ensure that:

- the number of audit offices and assignments reviewed will provide sufficient data to establish DCAA's overall level of compliance with GAGAS and DCAA policy;
- each audit office is eligible to be selected for a DCAA headquarters internal quality assurance review;
- the majority of the audit offices will actually undergo such a review within each 3-year planning cycle;
- all types of DCAA assignments with reports issued and performed in accordance with GAGAS will be included in the universe of assignments to be reviewed; and
- significant coverage of the different assignment types should be provided, while still providing sufficient data on any one type to enable meaningful conclusions to be drawn with regard to DCAA's level of compliance with a particular GAGAS requirement.

DCAA Instruction No. 7640.20 provides additional guidance and information on how the DCAA Integrity and Quality Assurance Directorate should perform its internal quality assurance reviews. The DCAA Integrity and Quality Assurance Directorate performs: (i) formal internal quality assurance reviews based on guidelines established by the CIGIE; and (ii) quality assurance-related review projects performed on a DCAA-wide basis. When performing these reviews, the DCAA Quality Assurance Directorate assesses compliance with applicable auditing standards and DCAA audit policies and procedures.

### ***DCAA Quality Assurance Reviews Identified Significant Deficiencies in DCAA Attestation Engagements***

During its internal quality assurance reviews of FY 2010 assignments, the DCAA Integrity and Quality Assurance Directorate determined that 50 percent of all assignments that it reviewed did not demonstrate professional judgment. The FY 2010 DCAA internal quality assurance reviews found that 50 percent of the reviewed assignments demonstrated a lack of professional judgment. The DCAA review results are lower than our finding of a 74 percent noncompliance rate for assignments performed during the same time period.<sup>19</sup> A summary of the FY 2010 DCAA Integrity and Quality Assurance Directorate review results are detailed in Table 3.

---

<sup>19</sup> One difference between our scope of review and the DCAA internal quality assurance program reviews was that our review included assignments performed by DCAA Field Detachment offices in addition to all five regions. The DCAA internal quality assurance reviews excluded Field Detachment assignments during the first half of FY 2010, but covered assignments from all five regions and Field Detachment for the second half of FY 2010.

**Table 3. FY 2010 DCAA Quality Assurance Review Results on Compliance with Professional Judgment Standard by Time Period**

<b>DCAA Quality Assurance Reviews</b>	<b>Number of Audit Offices Reviewed</b>	<b>Number of Assignments Reviewed</b>	<b>Number of Assignments Reviewed Not Meeting Professional Judgment Standard</b>	<b>Assignments Reviewed Not Meeting Professional Judgment Standard</b>
1 <sup>st</sup> Half FY 2010 (October through March)	13	219	92	42 percent
2 <sup>nd</sup> Half FY 2010 (April through September)	15	246	142	58 percent
<b>FY 2010 Results</b>	<b>28</b>	<b>465</b>	<b>234</b>	<b>50 percent</b>

For the second half of FY 2010, the DCAA Integrity and Quality Assurance Directorate reviews found an increase in the number of assignments not meeting the professional judgment standard from 42 percent to 58 percent. Based on the DCAA quality assurance review results, the Director, DCAA, determined that the audit offices needed additional training on compliance with GAGAS. From November 2010 to April 2011, the DCAA Integrity and Quality Assurance Directorate provided additional GAGAS training to all audit offices, regional offices and Field Detachment headquarters staff. We will assess the effectiveness of this training during future reviews.

### ***Inadequate Quality Control Procedures for Documentation of Personal Impairments***

We identified implementation deficiencies relating to documentation of personal impairments in 46 percent, 23 of the 50 reviewed assignments. DCAA quality control procedures for documenting and determining potential or actual impairments to personal independence were either not properly designed or did not operate effectively to ensure compliance with GAGAS requirements. As a result, we were unable to determine conclusively whether auditors who worked on the reviewed assignments had any personal impairments associated with the assignments. GAGAS 3.52 requires an audit organization to document compliance with its quality control policies and procedures and to maintain the documentation for a period of time sufficient to enable others to evaluate the extent of the audit organization's compliance with its quality control policies and procedures. GAGAS 3.53b lists policies and procedures designed to provide reasonable assurance that the audit organization and its personnel maintain independence as needed for its quality control system.

DCAA policy for documentation of personal independence required: (1) audit staff to complete the Statement of Independence (DCAA Form 7640-2) each year after completing annual independence training; (2) Regional Directors to certify annually that mandatory training and signing of Statements on Independence had occurred; (3) audit offices to maintain the most current Statements on Independence in the audit staff

personnel records maintained by the first level supervisor; (4) all newly hired auditors to complete the training and independence statement prior to working on an assignment; and (5) an auditor to notify the appropriate DCAA management official, in writing, of any exception. The policy does not provide a separate form or specific place on the independence statement form for the audit staff to document, describe, or explain the exceptions when the exception box is checked. DCAA should revise its guidance or Statement of Independence form to do so.

We identified deficiencies in the design and implementation of the quality control procedure for documenting personal impairments to independence, impacting 23 of the 50 reviewed assignments. Of the 309 audit staff members that worked on the reviewed assignments, we did not receive:

- any independence statements for 19 audit staff members;
- the current FY independence statements for 6 audit staff members; and
- properly filled in independence statements for 19 audit staff members. This included statements where the independence status boxes were not marked; the supervisor did not sign the statement; and recusal or exception letters or some type of written description of the exception were not provided as previously noted above in the Independence section of this report.

Additionally, 10 of the 309 audit staff members were newly hired auditors.<sup>20</sup> Fifty percent of the newly hired auditors, 5 out of 10, did not fill in the required independence statements prior to starting the reviewed assignment. In one case, a newly hired auditor did not complete the independence statement until 2 months after report issuance, and 7 months after being hired and completing the independence training. DCAA should perform an assessment of its on boarding process and associated management oversight and controls over completion of the Statements of Independence to determine how to better ensure that newly hired auditors submit a completed Statement of Independence as soon as possible after starting to work with DCAA as required by its quality control policies and procedures in its Contract Audit Manual (CAM).

### ***Changes to Procedures Should Improve Compliance with GAGAS***

In March 2010, the DCAA Integrity and Quality Assurance Directorate briefed us that they communicated concerns to DCAA management that audit offices were only keeping the current independence statement. Therefore, all of the needed independence statements were not available when the reviewed assignments carried over from prior fiscal years.<sup>21</sup> On August 2, 2011, DCAA issued Memorandum for Regional Directors (MRD) 11-PAS-013, “FY 2011 Annual Training on the Generally Accepted Government Auditing Standards (GAGAS) Independence Standards,” modifying the previous DCAA

---

<sup>20</sup> Newly hired auditors are auditor-trainees who have worked for DCAA for 1 year or less.

<sup>21</sup> Twenty-five of the 50 assignments we reviewed required independence statements from more than 1 year.

requirements pending the overall reassessment of independence documentation procedures. Audit offices are now to maintain not only the most current independence statements, but also annual independence statements from prior years that were filed in the audit staff personnel records maintained by the first-level supervisor. DCAA revised the process to ensure that the required independence statements are available for internal and external reviews. However, this guidance still does not address documenting written explanations provided by an auditor to the first-level supervisor for any identified exceptions. Therefore, additional improvements are needed to ensure that the related exception letters or written explanations are also maintained and available for reviewers. As noted above, DCAA is currently evaluating their overall policies for documenting independence. We will assess the effectiveness of the procedural change and any other policy changes in future reviews.

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

We recommend that the Director, Defense Contract Audit Agency:

- 5. Revise guidance on maintaining Statements of Independence to specify that all written explanations describing exceptions to personal independence provided to the first-level supervisor must also be maintained for the same period of time as the Statements.**

### **DCAA Comments**

DCAA agreed in principle stating that DCAA will revise policy so Statements of Independence are only applicable to a particular assignment and the associated contractor and will not include independence issues related to other contractors. DCAA stated it would complete this action by June 30, 2013.

### **Our Response**

DCAA comments and subsequent actions are fully responsive to the intent of the recommendation. On November 16, 2012, DCAA included a reminder in its FY 2013 announcement of annual training on GAGAS Independence Standards to retain annual independence statements from prior years and to attach any personal recusal letters to the independence statements. No additional comments are required.

- 6. Perform an assessment of the new hire on-boarding process and implement the additional steps or controls needed to ensure that newly hired auditors complete independence training and submit a Statement of Independence within the first week of work at the audit office or prior to working on any assignment, whichever event occurs first.**

## **DCAA Comments**

DCAA agreed in principle stating it would implement a consistent approach on the new hire on-boarding process that will include training on GAGAS Independence Statements, and require supervisors to explain auditor independence to the new hire to ensure they complete a Statement of Independence prior to performing any audit work. DCAA stated it would implement this process by December 3, 2012.

## **Our Response**

DCAA comments were responsive. No additional comments are required.

### ***DCAA Regional and Field Detachment Offices' Quality Control Procedures Need Improvement***

The DCAA regional and Field Detachment quality control procedures were generally ineffective in ensuring that attestation engagements and performance audits complied with GAGAS and DCAA policies and procedures. The quality control procedures including regional and Field Detachment management pre-issuance reviews varied among regions and Field Detachment. The regional and Field Detachment pre-issuance reviews did not identify significant noncompliances with GAGAS and resulted in the regional or Field Detachment audit managers approving reports that should not have been issued. In addition, the regions and Field Detachment management did not have adequate procedures in place to ensure that audit offices complied with the regional and Field Detachment quality control procedures for which the audit offices were assigned responsibility.

Only 32 percent, 16 of the 50 reviewed assignments included a regional or Field Detachment pre-issuance review of the report. Regional and Field Detachment management is responsible for maintaining quality control systems to provide reasonable assurance that auditors comply with professional standards and applicable legal and regulatory requirements. To perform this function, regional and Field Detachment directors issued instructions establishing regional or Field Detachment quality control programs that assigned regional audit managers certain responsibilities which vary among the different regions and Field Detachment. Quality control procedures performed by regional audit managers include reviewing high risk assignments and reports prior to their issuance, performing post-issuance reviews, or evaluating corrective action plans submitted in response to DCAA quality assurance reviews. In addition, most of the regions and Field Detachment quality control procedures require pre-release reviews by regional technical specialists of specific assignment types either before or concurrent with the regional audit manager reviews. However, the requirements for regional or Field Detachment management pre-issuance reviews also vary considerably between the regions and Field Detachment. Often whether a regional review is required depends on the significance of the dollars examined or the dollar amount of the findings.

Regional management reviews when performed also were not an effective quality control procedure to ensure that the engagements complied with GAGAS. Of the above 16 assignments in which regional or Field Detachment management reviewed and approved



the report to be issued, we determined that 12 lacked professional judgment and DCAA should not have issued those reports. For instance,

- A Central region regional audit manager approved the report issuance for an incurred cost examination engagement of \$102 million. However, the regional audit manager did not identify and have the audit office remedy several significant deficiencies during the required pre-release review of the assignment and draft report. In particular, the regional audit manager's review did not find that the auditor performed insufficient testing to support the opinion on claimed costs and that the report lacked several key qualifications. (Assignment Number 3171-2006J10100002)
- Both the regional audit manager and the regional technical programs division performed required pre-release reviews of an examination of the indirect and other direct cost system at a major defense contractor with \$3.4 billion in government sales. The regional audit manager commented in his approval e-mail that "the report looks real good." However, neither regional quality control review identified critical noncompliances with GAGAS. For instance, the supervisory auditor allowed the contractor to improperly influence the scope of testing performed on unallowable costs; evidence was insufficient to support the report; documentation of work performed to support the reported conclusions was inadequate; and the auditor did not follow-up to obtain a formal written response from the contractor on the reported deficiencies. (Assignment Number 1721-2009B14980001)

Finally, 13 audit offices did not have an audit office instruction documenting quality control policies and procedures as required by the respective regional or Field Detachment quality control instruction. Audit office noncompliance with regional or Field Detachment quality control procedures further weakened the effectiveness of such procedures.

DCAA regional and Field Detachment management should reassess their quality control programs and make revisions to increase the programs' effectiveness at promoting and ensuring audit quality. DCAA should consider establishing minimum requirements for regional and Field Detachment quality control procedures to increase consistency and the overall effectiveness of such procedures.

### ***Limited and Ineffective Audit Office-Specific Quality Control Procedures***

DCAA audit offices had limited and ineffective audit office-specific quality control procedures. Audit offices did not fully implement the use of participatory work team member reviews<sup>22</sup> to improve compliance with GAGAS. Some audit offices also did not

---

<sup>22</sup> DCAA uses the term "peer review" to denote one team member's review of another team member's assignment. Our report uses "participatory work team member review" when discussing this quality control procedure to avoid confusion with the "external peer review" required by GAGAS 3.55.

comply with the GAGAS requirement to maintain documentation on compliance with its quality control policies and procedures. Additionally, some audit offices did not comply with their own or regional or Field Detachment quality control procedure requirements further limiting the effectiveness of those procedures.

Only 24 of the 50 assignments reviewed required a participatory work team member review. DCAA guidance provides that its basic system of quality control encompasses its organizational structure. The guidance specifically includes participatory work teams as part of the organizational structure at the audit office level. DCAA headquarters encouraged audit offices to use participatory work teams to enhance the overall quality of their working papers and reports by increasing compliance with GAGAS. A participatory work team's responsibilities can vary and include:

- establishing a participatory work team member review process for the working paper files and reports to incorporate the number and type of assignments subject to the team member review;
- determining the objectives and scope for the participatory work team member review;
- determining how the auditor performing the participatory work team member review is to document the review and its results; or
- discussing general recurring type errors and process improvements at team meetings.

Despite participatory work team member reviews, we still identified a significant number of deficiencies and noncompliances with GAGAS. Our review determined that 12 of the 30 assignments with a documented participatory work team member review did not demonstrate professional judgment. DCAA needs to reconsider the usefulness of the participatory work team member review process as a quality control procedure.

In addition, 4 of the 24 assignments that required participatory work team member reviews did not contain evidence of the required review or the audit office did not provide us acceptable documentation that the required procedures had been performed. GAGAS 3.52 provides that an audit organization should document compliance with its quality control policies and procedures, and maintain the documentation so that other reviewers can evaluate the extent of the organization's compliance with its quality control policies and procedures. Therefore, to comply with GAGAS, all audit offices need to maintain such documentation.

Finally, audit offices did not comply with all their own required quality control procedures or all the regional or Field Detachment management required procedures. As mentioned above, not all audit offices had a required office quality control procedure. Of the 50 assignments reviewed, 16 were performed at audit offices that also did not comply with applicable region or audit office-required supplemental quality control procedures, forms, or checklists for assignments.

## ***Independent Reference Review Requirement Implemented to Improve Quality***

DCAA implemented the use of independent reference reviews as a component of its commitment to providing quality reports in compliance with applicable standards. On July 25, 2011, DCAA issued guidance requiring audit offices to assign General Schedule [GS] 13 audit staff to perform independent reference reviews for certain specified engagements requiring a report as well as any assignments that pertain to sensitive, controversial, complex, unusual, or significant matters. The guidance requires that all independent reference review documentation be maintained in the working paper file. We will review the implementation and its effectiveness in future reviews.

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

- 7. Issue guidance directing regions, Field Detachment, and audit offices to fully comply with generally accepted government auditing standards paragraph 3.52 requirements to maintain documentation of all quality control procedures performed by the regions, Field Detachment, or audit offices such as participatory team member reviews or regional audit manager pre-release reviews, for a sufficient amount of time so that reviewers can evaluate the extent of their compliance with the relevant quality control procedure.**

### **DCAA Comments**

DCAA agreed in principle stating that the implementation of the DCAA independent reference review policy and actions that will result from the in-process publication reform initiative would address this recommendation. DCAA also stated that its publication system reform initiative to review regional and Field Detachment quality control publications to ensure consistency across the agency and eliminate publications that are, or should be, addressed agency-wide would be completed by March 31, 2013.

### **Our Response**

DCAA comments were responsive. No additional comments are required. As part of our followup and monitoring responsibilities, we will consider whether the in-process publication reform initiative fully satisfies the intent of this recommendation.

- 8. Review existing audit office, regional, and Field Detachment quality control procedures to identify best practices or other possible quality procedures to be implemented that would be effective in ensuring audit quality and compliance with government auditing standards. The review should**

**consider establishing minimum standards for regional and Field Detachment quality control procedures, as well as audit office quality control procedures, to better ensure effective implementation of the DCAA quality control system.**

## **DCAA Comments**

DCAA agreed in principle stating that DCAA communicates best practices through training, staff conference presentations, its Quality website, and in quality assurance review reports. DCAA also stated it would complete its publication system reform initiative, as discussed in response to Recommendation 7, by March 31, 2013.

## **Our Response**

Management comments were responsive. No additional comments are required.

# **Examination Engagements**

## **Planning**

### ***Deficiencies in Planning***

Thirty-one (31) of the 47 reviewed examination engagements<sup>23</sup> did not comply with GAGAS requirements for planning. Most deficiencies were caused by poor risk assessments, incomplete identification of relevant criteria, failure to follow up on prior review results, inadequate understanding of internal controls, and lack of coordination with other auditors. GAGAS 6.04a. requires the auditor to adequately plan the work. According to the AICPA standards for attestations engagements, planning involves developing an overall strategy for the expected conduct and scope of the engagement. The auditor should consider the nature, extent, and timing of the work to be performed to accomplish the objectives of the engagement. During the planning process, an auditor should consider the criteria to be used; preliminary judgment about risk and materiality; the nature of the subject matter or the items within the assertion that are likely to require revision or adjustment; conditions that may require extension or modification of procedures; and the nature of the report to be issued.

### **Planning Deficiencies Identified with AICPA Attestation Standards**

Table 5 provides examples of the deficiencies in DCAA engagement planning in relation to the AICPA Attestation Standards incorporated into GAGAS.

---

<sup>23</sup> An examination engagement or examination provides positive assurance. GAGAS 1.23a states that an examination "...[c]onsists of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria."

**Table 5. Examples of Planning Deficiencies**

Area	Planning Deficiencies Examples
<p>Identification of Criteria to Be Used</p> <p>AT<sup>24</sup> 101.45a</p>	<p>In eight examination engagements, the auditor did not identify the appropriate criteria to be used in performing the engagement. This is a repeat deficiency identified in our prior review of the FY 2006 DCAA quality control system. DCAA non-concurred with our previously recommended corrective action to list specific criteria on the planning documentation because they felt the existing DCAA guidance was sufficient to comply with GAGAS.</p> <ul style="list-style-type: none"> <li>• In an examination of billed mentor protégé costs of \$1.2 million, the auditor identified numerous sources for criteria including the Department of Navy Mentor Protégé Program Procedures Manual, but failed to use the correct version of the manual. The auditor used the December 2008 instead of the May 2005 version in effect at the contract signing. The error was not identified until the contractor responded to the findings. The auditor verified that the requirement used to support the finding had not changed from the 2005 version, but did not verify whether any other provisions used as criteria were different. Additionally, the auditor did not include all pertinent contract terms in the contract brief to use as criteria. The oversight resulted in the auditor identifying an erroneous finding regarding lease purchase of equipment that was allowed by the contract. Incomplete or inaccurate criteria used during planning and not corrected during execution results in the auditor spending additional time to correct the preliminary findings. (Assignment No. 1661-2009H17900002)</li> </ul>
<p>Preliminary Judgments on Risk and Materiality</p> <p>AT 101.45b</p>	<p>In nine examination engagements, the auditor did not adequately address the materiality and sensitivity of the engagement.</p> <ul style="list-style-type: none"> <li>• During the examination of a large contractor's billing system, the auditor did not complete the required Internal Control Audit Planning Summary working paper. The auditor should use this information to determine the appropriate risk level for planning the engagement. The audit office did not reconcile or address a significant discrepancy regarding the amount of dollars being processed through the billing system. The auditor stated in the risk assessment steps that the system processed approximately \$34 million, but another working paper showed approximately \$4.396 billion as being processed. One of the key factors for the level of internal control testing needed is the dollars processed through the system. (Assignment No. 2641-2009C11010001)</li> </ul>
<p>Sufficient Knowledge of Events, Transaction,</p>	<p>In eight examination engagements, the auditor did not document all relevant background information needed to adequately evaluate the subject matter of the engagements.</p>

<sup>24</sup> The AICPA uses the designation of "AT" to reference the various attestation standards.

Area	Planning Deficiencies Examples
<p>and Practices/Background Information</p> <p>AT 101.44</p>	<ul style="list-style-type: none"> <li>In a purchasing system examination of a contractor with \$140 million in sales, the auditor stated in the working papers that they would request organizational charts, pertinent records layout, database source documents, information on the conversion of documents to computer media, and a listing of files affected by the system. However, the auditor never received the documents that were needed to properly plan the engagement. (Assignment No. 1261-2010A12030001)</li> </ul>
<p>Significant Changes</p> <p>AT 101.45d &amp; 101.47</p>	<p>In five examination engagements, the auditor did not make the appropriate changes to the planned work due to circumstances that arose in the engagement.</p> <ul style="list-style-type: none"> <li>In a disclosure statement adequacy examination at a contractor with sales of \$320 million in 2008, the auditor acknowledged the contracting officer's request for a disclosure statement review for adequacy and compliance; however, the auditor only performed an adequacy review. The auditor did not document a reason for the reduced scope of work, or inform the contracting officer of the adjustment in planned work. Although the audit office stated a compliance review would be done under a separate assignment, it was never performed. Therefore, the Government cannot be certain that the contractor is following its disclosed practice and not overcharging contracts for the costs. (Assignment No. 9811-2009A19100001)</li> </ul>
<p>Nature, Extent, and Timing of the Work to be Performed to Accomplish the Objectives</p> <p>AT 101.47</p>	<p>The auditor did not properly consider the nature, extent, and timing of the work to be performed to accomplish the objectives of the engagement in seven examination engagements.</p> <ul style="list-style-type: none"> <li>During a pre-award accounting system examination of a small contractor with \$510,000 in sales, the auditor did not properly define the scope. The auditor failed to verify the listing of current contracts and subcontracts provided by the contractor and, therefore, missed including the contractor's subcontracts with the U. S. Navy and Department of Homeland Security. This omission unnecessarily limited the scope of the engagement and resulted in the auditor verifying costs to a project that was not representative of the type of subcontract that was proposed. (Assignment No. 6431-2009B17740013)</li> </ul>

## Planning Deficiencies Identified with GAGAS Specific Requirements

***Insufficient Follow up on Significant Issues.*** In 10 of the 47 examination engagements, the auditor did not follow up on significant findings and deficiencies identified in previous engagements. Specifically, the auditor did not use this information in assessing risk and determining the nature, timing, and extent of current work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current engagement objectives. GAGAS 6.09 states that auditors should evaluate whether the audited entity has taken appropriate corrective action to address

findings and recommendations from previous engagements that could have a material effect on the subject matter. Examples of instances where the auditor failed to follow up on significant findings and recommendations from previous engagements included:

- During an adequacy of disclosure statement examination engagement at a contractor with total sales of \$320 million, the auditor did not follow-up on a Cost Accounting Standard noncompliance identified in another engagement. Specifically, the auditor stated that the noncompliance would be addressed in this engagement. However, the auditor did not perform any work to determine whether the noncompliance currently existed. This resulted in the audit office not performing work needed to opine, in the future, on the contractor's general and administrative rate. (Assignment Number 9811-2009A19100001)
- During a \$151.7 million incurred cost examination engagement, the auditor did not follow-up and report on expressly unallowable costs that were a significant portion of the \$3.8 million in questioned indirect expenses identified in the subpackages<sup>25</sup> to this engagement. Because the auditor failed to follow-up and recognize the costs as expressly unallowable, penalties were not appropriately assessed against the contractor. (Assignment Number 9851-2005F10100014)

***Failure to Obtain a Sufficient Understanding of Internal Controls.*** In 9 of the 47 examination engagements reviewed, the auditor did not obtain a sufficient understanding of internal controls to properly plan the examination engagement. GAGAS 6.10 requires the auditor to obtain such an understanding of internal controls material to the subject matter to plan the engagement and design procedures to achieve the engagement objectives. An understanding of the relevant internal controls is needed to determine the appropriate procedures to perform, the appropriate evidence needed, and the required amount of testing. For instance, in an incurred cost examination engagement of a contractor with \$78 million in sales, the auditor did not complete the DCAA-required internal control questionnaire which documents the auditor's understanding of the contractor's basic internal controls. Without this information, the auditor cannot complete and document a thorough risk assessment, and properly plan and execute the engagement. Therefore, there is a potential for DCAA to have accepted and the Government to have reimbursed the contractor for unallowable costs. (Assignment Number 6161-2005A10100022)

***New Guidance for Documenting Understanding of Internal Controls.*** In September 2011, DCAA issued new guidance revising its process for documenting relevant internal controls to provide a better link between the risk assessment, including the understanding of internal controls, and the decision of what procedures to perform. DCAA issued the revised guidance to increase compliance with GAGAS 6.10 and AT 601.45. As a first step in the revised process, the auditor should identify the

---

<sup>25</sup> Supervisory auditors have the flexibility to subdivide engagements into several assignments. When done, one assignment is the overall engagement and the other related assignments become working paper sections of the overall engagement assignment. The assignments that act as working paper sections are sometimes called 'subpackages' to further distinguish them from engagement assignments.



significant cost elements or subelements (e.g., accounts or groups of accounts) or other areas to be evaluated based on materiality and other inherent risk factors. Next, for each of those areas, the auditor should:

- consider what potential noncompliances could occur;
- identify and document the key policies and procedures or internal controls over compliance;
- document previously reported deficiencies; and
- tailor the procedures accordingly to address the overall risk.

Previously DCAA documented the understanding of internal control primarily by referencing work done in prior audits of contractor systems and related internal controls. DCAA also created a new standard electronic working paper to document the revised process with accompanying instructions for completing the working paper. These revisions, however, will not impact all of our identified noncompliances with GAGAS requirements on planning, particularly the noncompliances related to identifying and documenting the relevant criteria and materiality and sensitivity factors. We have not reviewed the implementation of the revised process, but we will monitor its implementation and DCAA improvement in the areas of planning and risk assessment through our continuous oversight of DCAA.

## **Planning Deficiencies Identified with DCAA Guidance**

***Inadequate Coordination on Work Performed by Others.*** In 14 of the 47 examination engagements reviewed, the auditor did not adequately coordinate with others. The DCAA CAM 4-1003, “Work Performed by Others,” states that an important source of evidence is work performed by other DCAA or Government auditors, contract administration officials, independent public accountants, contractor internal auditors and non-auditors. Thus DCAA guidance emphasizes the importance of maintaining effective communications with these groups, understanding their responsibilities, and knowing when it is appropriate to request their assistance or rely on their work. Further, coordinating with these groups can often provide additional evidence and avoid duplication of effort.

***Coordination with Other DCAA Audit Offices.*** In 4 of the 14 examination engagements, the auditor did not coordinate with other DCAA auditors. Due to the lack of coordination, the auditor failed to obtain relevant evidence needed to afford a reasonable basis for conclusions and recommendations. For instance, during a \$1.9 billion firm-fixed price/cost-plus-fixed-fee proposal examination, the auditor did not request an assist audit<sup>26</sup> from the DCAA audit office cognizant of the proposed

---

<sup>26</sup> Assist audits occur when one DCAA auditor at one location is furnished assistance in the form of a GAGAS-compliant engagement or audit by a DCAA auditor at another location. DCAA audit offices perform work at contractor locations within a defined geographic location and a prime contractor may include costs not supported by the books and records maintained at its geographic location. DCAA audit offices generally perform assist audits on subcontracts, offsite labor, or on costs that are allocated from or to records which are maintained at home offices, other divisions, segments, cost centers, etc. The DCAA

subcontract costs. The auditor stated that an assist audit of the \$162 million subcontract costs would be requested; however, the auditor failed to execute the request with no explanation as to why this was not done. Therefore, DCAA accepted the \$162 million in proposed subcontract costs, possibly resulting in the Government paying the contractor more than necessary on the subcontract. (Assignment Number 3531-2009L21000011)

**Work of Internal or External Auditors.** In 10 of the 47 examination engagements, the auditor did not appropriately consider procedures performed by contractor internal or external auditors in determining the nature, timing, and extent of the procedures to be performed. The DCAA CAM 4-202, “Relationships with Contractor Internal and External Auditors,” states that when contractors make internal or external reports available to DCAA, the auditor should review the reports to determine if there are any reported items that need follow-up or affect in-process examinations. Due to this lack of consideration, the auditor did not address the potential for opportunities in planning and performing the examination in coordination with the external or internal auditors to avoid duplication and reduce overall costs to the entity and the Government. Examples of instances where the auditor did not consider procedures performed by contractor internal or external auditors included:

- During a floor check examination engagement at a large contractor, the auditor did not request contractor internal audits of the labor system as required by the standard audit program. Instead, the auditor documented that a prior audit was qualified stating that it is contractor policy not to provide DCAA with its internal audit working papers. As a result, the auditor did not determine whether any relevant contractor internal audit reports existed and request them. The auditor should have used information in the contractor internal audit reports to determine whether additional risk factors, especially relating to potential fraud, existed. Without this information, the auditor was not sure that all appropriate procedures were performed. Refusal of a contractor to provide its internal audit working papers does not relieve the auditor from determining what internal audit reviews have been performed and obtain any information on them that the contractor is willing to provide. (Assignment Number 6211-2009C13500003)
- During an internal control examination of a labor accounting system that processed \$81 million in 2008, the auditor obtained a copy of a contractor internal audit report which concluded that adherence to timecard and labor input controls remained inadequate. The auditor failed to evaluate the contractor internal audit report and determine its effect on procedures performed in this engagement. Therefore, the auditor may not have performed the most appropriate procedures resulting in an inefficient use of resources and failure to identify potential fraud indicators. (Assignment Number 3191-2009F13010001)

---

audit office cognizant of the prime contractor is responsible for identifying the elements of cost requiring assist audits and requesting the assist audits.

# **Recommendations, Management Comments, and Our Response**

## **Recommendations**

We recommend that the Director, Defense Contract Audit Agency:

- 9. Review the electronic standard working paper software and documents in the “Audit Planning & Performance System” to determine appropriate revisions to prompt auditor compliance with government auditing standards and Defense Contract Audit Agency policies and procedures such as:**
  - a. Require the listing of specific criteria in the source section of each working paper.**

## **DCAA Comments**

DCAA agreed. DCAA stated that it would revise its Audit Planning and Performance System to require the identification of criteria specific to an evaluation in the applicable working paper by December 31, 2012.

## **Our Response**

DCAA comments were responsive. On September 19, 2012, DCAA provided an example of the on-page note generated by the Audit Planning and Performance System and the update to DCAA Contract Audit Manual Chapter 4-403g(4) requiring the auditor to document in the scope of analysis the specific criteria used to make judgments and conclusions. No additional comments are required.

- b. Revise all standard risk assessment working papers to require the auditor to list the factors used to determine the materiality and sensitivity of the assignment.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that the current DCAA risk assessment working papers (DCAA standard working paper B) for all assignments already require the auditor to document significant materiality and sensitivity factors and assess the effect of those factors on the assertion and cost elements under review. DCAA considers this action complete.

## **Our Response**

DCAA comments were partially responsive to the intent of the recommendation. On September 19, 2012, October 4, 2012, and October 31, 2012, DCAA provided the standard risk assessment working papers for all examination assignments as generated from the Audit Planning and Performance System. DCAA also responded to follow-up questions about their use and content. Most of the standard risk assessment working papers include a section to document materiality and sensitivity factors and also provide a

listing of factors to consider when completing this working paper section. However, DCAA uses a generic risk assessment working paper for numerous examination-level assignments that does not include a section to document and plan for materiality and sensitivity factors. Some audit assignments that use the generic standard risk assessment working paper include those for performing concurrent incurred cost audits, progress payment audits, and some cost accounting standards audits. Including a listing of factors to consider is not sufficient implementing guidance without a description or explanation of the individual factors. For instance, the DCAA Contract Audit Manual Chapter 3-104 includes a detailed discussion of individual factors affecting audit scope that encompasses many of the materiality and sensitivity factors that are listed on the standard generic risk assessment working paper. Adding a reference to the applicable DCAA Contract Audit Manual on the risk assessment working paper would provide supporting information for auditors to use when completing this important step in audit planning. We request that DCAA to provide additional comments in response to the final report, giving further consideration to including a working paper section on documenting and planning for materiality and sensitivity factors.

- c. **Add a procedure to the concluding steps to remind the auditor that additional procedures need to be considered and performed when internal control deficiencies or potential fraud, illegal acts, abuse, or violations of contract provisions are identified.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that it issued guidance on reporting business system deficiencies in MRD 12-PAS-012 on April 24, 2012, and revised applicable standard audit programs to include planning meetings with the audit team to discuss risk of fraud and other noncompliances as a risk assessment procedure. DCAA also stated that audit procedures to test the contractor's compliance with applicable laws, regulations, and contract terms exist throughout the audits and contractor compliance with these criteria is the primary objective of most DCAA audits. DCAA considers the actions to address this recommendation complete.

## **Our Response**

DCAA comments were generally responsive. No additional comments are required. As part of our followup and monitoring responsibilities, we will consider whether the guidance, revised programs, and audit procedures are sufficient.

## **Auditor Communication During Planning**

### ***DCAA Policies Not in Compliance with GAGAS***

In all of the 47 examination engagements reviewed, DCAA did not comply with GAGAS requirements for auditor communication during planning. GAGAS 6.07 requires the auditor to communicate certain information, including the auditor's understanding of the services to be performed for the engagement, in writing, to entity management, those

charged with governance, and to the individuals contracting for or requesting the engagement. The required information includes:

- nature, timing, and extent of planned testing and reporting;
- the level of assurance the auditor will provide; and
- any potential restriction on the auditors' report, to reduce the risk that the needs or expectations of the parties involved may be misinterpreted.

Communication of specific information in relation to attestation engagements is particularly important. Therefore, GAGAS and AICPA standards emphasize use of written communication to reduce the risk that the needs or expectations of the parties involved are misinterpreted. The majority of the deficiencies occurred because the applicable DCAA guidance did not adequately cover the GAGAS requirements for written communication with the contractor representative (entity management) or the contracting officer (requester) of the attestation engagement.

### ***Written Communication with Contractor Management Not Compliant with GAGAS Requirements***

DCAA did not comply with GAGAS 6.07 requirements to communicate, in writing, certain specific information to contractor management. Communication of certain information regarding the scope of the engagement and timeline for performance of and reporting on the engagement is of particular importance to contractor management. Putting the information in writing helps to avoid potential misunderstandings between the auditor and the contractor regarding the engagement. Examples of noncompliances related to written communication included:

- In 47 examination engagements, the auditor did not provide the contractor written notification of potential report restrictions.
- In 45 of the 47 examination engagements, the auditor did not inform, in writing, the contractor of the level of assurance to be provided in the report.
- In 39 of the 47 examination engagements, the auditor failed to provide the contractor information, in writing, on the nature, timing, or extent of planned testing or reporting.

DCAA guidance in effect during our review provided that the auditor should communicate the GAGAS-required information to a representative of the organization audited such as the audit liaison, corporate controller, or chief financial officer. This DCAA policy, however, did not require the auditor to provide the information in writing. Also, while standard audit programs prompted the auditor to hold an entrance conference with the contractor's representative, they did not mention the requirement to provide the information to the contractor in writing. For an entrance conference, CAM 4-302.1.a. only told the auditor to "document the date, participant's names and title, and primary discussion points, including specific identification of the requested data to control what was requested and provided during the audit." Therefore, the DCAA policy and procedures did not adequately direct the auditor to perform all required activities needed to comply with the GAGAS requirements for auditor communications.

## ***Communications with Requester Not Fully Compliant with Requirements and DCAA Guidance***

In 38 examination engagements reviewed, DCAA did not comply with GAGAS 6.07 requirements to communicate, in writing, certain specific information to the requester or contracting official. For instance:

- In 22 of the 47 examination engagements, the auditor did not provide the requester or contracting official information, in writing, on the nature, timing, or extent of planned testing or reporting.
- In 32 of the 47 examination engagements, the auditor did not inform, in writing, the requester or contracting official of the level of assurance to be provided in the report.
- In 36 of the 47 examination engagements, the auditor did not provide the requester or contracting official written notification of potential report restrictions.

Auditors did not always comply with DCAA guidance for written notification to contracting officials and related GAGAS requirements. We found noncompliances in all 20 self-initiated or non-requested engagements.

- In 13 of the 20 self-initiated or non-requested examination engagements, the auditor's written notification to the contracting official did not include all content required by DCAA guidance.
- In 7 of the 20 self-initiated or non-requested examination engagements, the auditor did not issue any written notification to the contracting official.

Written communication with the requester or user is particularly important to ensure that the requester or user fully understands the level of assurance to be provided and when it will be received. This information allows the requester or user to manage the remainder of the negotiation or contract administration process and ultimately meet the end user's needs.

DCAA guidance for communication with the requester or contracting official in effect during our review required the auditor to send an acknowledgment letter in a timely manner in response to requests for audit services received from a customer. The auditor was also directed to send a notification letter to the planned recipient of the report for engagements that have not been requested or are self-initiated such as incurred cost audits, internal control system audits, and post-award audits. The content of the acknowledgment or notification was to include the assignment number and type; scope, objectives, and key procedures; opportunity for customer concerns or feedback on the planned scope; whether technical assistance was required; information about in-process communication; and the planned report date. The guidance also included examples of acknowledgment and notification letters to illustrate the communication requirements. The majority of the deficiencies we identified, however, related to not providing the requester or the contracting official a clear explanation of the level of assurance to be provided or the potential report restrictions. These criteria were not specifically part of the acknowledgment or notification letter content in the DCAA guidance.

## ***Revised DCAA Guidance on Written Communications Needs Further Improvements***

From September 2010 through June 2012, DCAA made incremental improvements in its guidance on written communications. In FY 2010, DCAA issued guidance reminders to audit offices of the requirement to send an acknowledgement or notification letter to the contracting official and contractor representative for each engagement and further clarified its guidance in FY 2011. As of June 2012, all standard audit programs contained a step for providing the GAGAS-required written notification to the contractor and the contracting officials. Additional guidance revisions are still needed to improve audit office compliance with GAGAS.

DCAA first reminded audit offices of the requirement to issue an acknowledgement or notification letter in its September 9, 2010, The Rules of Engagement, guidance. However, this guidance did not address the deficiencies we identified in the information provided to the requester or user. Additionally, it did not require the audit offices to provide the same information provided to the requester to the contractor, in writing, as required by GAGAS. On December 15, 2010, DCAA instructed its auditors to immediately issue a notification letter to the contractor for all new engagements and those currently in the planning phase. The guidance also emphasized that the auditor should ensure that an acknowledgement or notification letter was issued to the contracting official for all engagements, including self-initiated or non-requested ones. The examples provided to the audit offices of an acknowledgement or notification memorandum to be sent to the contracting official and the notification letter to be sent to the contractor generally included the GAGAS-required information.

On August 19, 2011, DCAA revised the CAM guidance and moved the acknowledgement and notification letters examples from the CAM to the standard electronic working paper packages and its intranet library. Additionally, as of June 2012, DCAA revised all applicable standard audit programs to include steps for sending both contractor notification letters and contracting official acknowledgement or notification letters as part of the preliminary steps. However, to be consistent with GAGAS, the acknowledgement or notification memorandum to the contracting official and the notification letter to the contractor should clearly state that the level of assurance provided by an examination engagement is "...to obtain reasonable assurance about whether...are free of material misstatement." DCAA guidance should also require the auditor to identify the nature of the engagement as an examination engagement. The previous examples incorrectly use the term "audit" instead of "examination."

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

**10. Revise the guidance and examples of Acknowledgement and Notification Letters to comply with generally accepted government auditing standard paragraph 6.07 on auditor communication during planning.**

## **DCAA Comments**

DCAA agreed. DCAA stated that it revised the acknowledgement and notification letters in the Audit Planning and Performance System on September 10, 2012, to state that an examination-level attestation engagement will be performed. DCAA considers actions taken to address this recommendation as complete.

## **Our Response**

DCAA comments were responsive. On September 21, 2012, DCAA provided the revised letters that are now being delivered in the Audit Performance and Planning System. No additional comments are required.

## **Evidence**

### ***Insufficient Evidence Obtained to Address Engagement Objectives***

In 36 of the 47 examination engagements, the auditor did not obtain sufficient, appropriate evidence to address engagement objectives and support significant judgments and conclusions. Auditors should determine the overall sufficiency and appropriateness of evidence needed to provide a reasonable basis for the findings and conclusions. Specifically, the auditor did not perform enough testing, complete planned procedures, or use the correct criteria during testing. GAGAS 6.04b requires the auditor to obtain sufficient evidence to provide a reasonable basis for the conclusion expressed in the report. Furthermore, GAGAS 6.15 requires that when deficiencies are identified, the auditor should plan and perform procedures to develop the elements of the findings (criteria, condition, cause and effect) that are relevant and necessary to achieve the engagement objectives. On May 2, 2012, DCAA issued MRD 12-PAS-015(R), "Audit Guidance on Performing Sufficient Testing," which covered risk assessment procedures, tests of controls and substantive procedures, sufficient appropriate evidence, selecting items for testing, and documentation requirements. The guidance also contained three example scenarios of sufficient testing and procedures for testing estimates based on unaudited historical data. We have not reviewed the effectiveness of this guidance on DCAA compliance with GAGAS; however, we will monitor improvement in this area through our continuous oversight of DCAA.

### ***Sufficiency of Evidence***

In determining sufficiency of evidence, auditors should evaluate whether enough appropriate evidence exists to address the examination objectives and support the findings and conclusions. Failure to obtain sufficient evidence resulted in unsupported findings and conclusions. Examples of insufficient evidence included:



- During a \$151.7 million incurred cost examination engagement, the auditor relied solely on insufficient testing of \$81.6 million in direct labor costs performed in a separate engagement to determine whether the labor costs were acceptable. The scope of the separate engagement was limited to performing a floor check of 31 out of 800 employees. Failure to perform additional testing of the claimed \$81.6 million in labor costs during the incurred cost audit and relying on the insufficient testing performed in the separate engagement caused the auditor to inappropriately accept all of the claimed incurred labor costs as allowable for final payment by the Government. (Assignment Number 9851-2005F10100014)
- During a forward pricing rate proposal examination engagement performed at a contractor with total sales of \$132.9 million, the auditor tested only one of seven proposed rates, but expressed an opinion on all of the rates. Also, the auditor did not adequately review one indirect rate which had proposed base year expenses of approximately \$1 million. The auditor failed to update the analysis of proposed indirect costs with actual costs that were available prior to the report issuance. Therefore, the work performed did not provide an acceptable basis for the Government to use when negotiating contracts with the contractor potentially resulting in a contracting officer unnecessarily spending Government funds. (Assignment Number 2651-2009H23000006)

## ***Statistical and Nonstatistical Samples***

### **Statistical Sampling Plans**

In seven of eight examination engagements using statistical sampling, the auditor did not use an appropriate confidence level<sup>27</sup> in the statistical sampling plan. Specifically, the auditor used a confidence level of less than 90 percent that resulted in a sample size for transaction testing that was too small. As a result, potential deficiencies and questioned costs were not identified or reported, and the Government could have reimbursed the contractor for unallowable costs. Examples of insufficient testing that resulted from inadequate statistical sampling plans included the following:

- During a \$102.3 million incurred cost examination engagement, the auditor used a 70 percent confidence level and 50 percent error rate<sup>28</sup> in the statistical sample of indirect expenses. In one sample, the auditor only selected 4 out of 51 items representing 25 percent of the costs charged for human resource benefits. (Assignment Number 6151-2007N10100001)

---

<sup>27</sup> The confidence level is the assurance or probability that the amount being estimated by the sample will fall within a specified range (or interval) determined by the sample results. A confidence level is commonly defined as the point estimate plus or minus the precision amount. For instance, a 90 percent confidence level indicates that with repeated sampling under the same sampling plan, 90 times out of 100, the actual universe amount is expected to be within the interval computed from the sample results. In practical terms, this means that any single sample has a 90 percent chance of producing a result, in this case cost questioned, that is the actual amount in the universe.

<sup>28</sup> The error rate refers to the expected amount of dollar errors found in the universe.

- During a \$96 million firm-fixed price proposal examination engagement, the auditor used a 70 percent confidence level and 25 percent error rate in the statistical sampling plan to review the proposed \$25.8 million bill of material, which resulted in an insufficient sample and limited testing to 28 of the 507 items. (Assignment Number 3561-2009D21000013)

DOD IG Audit Policy and Oversight issued APO Memo No. 2010-CAPO-005, “Adequacy of Defense Contract Audit Agency Statistical Sample Plans,” on May 28, 2010, that recommended the appropriate use of statistical sampling applications to ensure that sufficient evidence is obtained. Specifically, APO recommended the use of a minimum of 90 percent confidence level in statistical sampling applications for variables; revision of DCAA CAM guidance and formal training courses and materials; and training for all audit staff. In response to our recommendations, DCAA revised their guidance by issuing MRD 10-OTS-051(NR), “Guidance on Variable Sampling Policy,”<sup>29</sup> dated August 31, 2010, and MRD 10-OTS-069(R), “Attribute Sampling Policy,” dated October 20, 2010, which incorporated the use of a 90 percent confidence level in determining sample sizes. These guidance documents also addressed reporting sample results in reports. We have not reviewed the implementation of this guidance; however, we will monitor improvement in this area through our continuous oversight of DCAA.

## Nonstatistical Sampling Plans

In 9 of the 23 examination engagements<sup>30</sup> reviewed that used nonstatistical sampling,<sup>31</sup> the auditor did not have a nonstatistical sampling plan for the selection of items for testing. Due to the auditor not using the criteria outlined in MRD 09-PAS-003, “Audit Guidance on Working Paper Documentation of Judgmental Selections,” dated January 30, 2009, the auditor did not develop an adequate sampling plan and select a sufficient number of transactions for testing. Therefore, the Government may have reimbursed the contractors for unallowable costs or negotiated a higher contract value than it should have. Examples of insufficient testing that resulted from inadequate nonstatistical sampling plans included:

- During a \$16.4 million incurred cost examination engagement, the auditor did not use an appropriate nonstatistical sampling plan for testing incurred labor costs. This deficiency resulted in the auditor evaluating roughly 1 percent of the total direct labor costs (\$64,349 of \$5.4 million). The auditor did not identify the total universe for direct labor costs as \$5.4 million, or the total number of contractor employees. Instead, the auditor used a direct labor cost universe of \$2.1 million

---

<sup>29</sup> DCAA later reissued this guidance as MRD 11-OTS-001(R) on January 3, 2011, to allow the document to be released to the general public. The guidance itself did not change.

<sup>30</sup> In some of the 47 examination engagements reviewed, the auditor did not use sampling methods because the nature of the assignment did not require transaction testing (e.g. forward pricing rate proposal and CAS compliance reviews), the auditor failed to perform transaction testing, or the auditor relied solely on testing performed in other assignments.

<sup>31</sup> This refers to reviewing less than 100 percent of the transactions but not statistically projecting the result to the transaction universe.

- that represented direct labor claimed on only 4 high dollar contracts. To make matters worse, the auditor then only tested 3 percent (\$64,349 out of \$2.1 million) of the misidentified direct labor cost universe by testing only 8 employees' charges for just 2 pay periods. (Assignment Number 6161-2005A10100022)
- During a \$41.2 million cost realism proposal examination engagement, the auditor did not identify the universe of transactions in the 4 accounts selected or the basis for the account selection. The auditor also gathered insufficient evidence to achieve the engagement's objectives because the auditor did not address differences identified between the contractor's submission and the general ledger. When the submission and general ledger accounts do not reconcile, the Government is not assured that the contractor was only reimbursed actual allowable costs. (Assignment Number 3521-2010V27000003)

### ***Failure to Perform Sufficient Work to Achieve Objectives***

In some reviewed examination engagements, the auditor failed to perform sufficient work to achieve all of the engagement objectives because some of the procedures were not performed or not performed properly. GAGAS 6.15 states that a finding or a set of findings is complete to the extent that the engagement objectives are satisfied. For instance, during the testing of claimed consultant fees in a \$681,000 incurred cost examination engagement, the auditor did not identify that a consulting agreement was only valid for 90 days. The contractor claimed \$14,243 for services performed on the contract for the entire year. One engagement objective was to determine the allowability of the claimed costs. Because the auditor did not test the claimed costs against key criteria such as time limitations, the auditor did not fully satisfy the objective. The Government overpaid the contractor \$12,229 in consultant fees. (Assignment Number 4171-2006G10100007)

### ***Insufficient Evidence to Support Internal Control System Reviews***

DCAA did not obtain and analyze sufficient evidence to support the findings and conclusions in five of the six<sup>32</sup> internal control system examination engagements we reviewed. The auditors did not perform sufficient compliance testing on all relevant control objectives and did not perform all procedures needed to address the engagement objectives. The GAO also reported similar testing deficiencies in its September 2009 Report No. GAO-09-468, "Widespread Problems with Audit Quality Require Significant Reform." DCAA uses the results from various internal control system reviews when planning related engagements involving the same contractor. Therefore, inadequately performed internal control system reviews negatively impact DCAA's compliance with GAGAS 6.10 and 6.11 requirements to obtain a sufficient understanding of internal control and resulted in insufficient testing in assignments that relied on the results of these reviews. Examples of inadequate internal control system reviews included:

---

<sup>32</sup> DCAA did not perform one of the seven internal control system examination engagements, Assignment Number 1261-2010A12030001, as an internal control system review. Therefore, we did not include the deficiencies identified in this engagement in this report section.

- In an examination engagement of a labor accounting system that processed \$81 million, the auditor performed limited or insufficient testing of internal controls for seven out of eight control objectives. Control objectives not tested included Employee Awareness Training, Labor Authorization Approvals, Manual or Automated System, Labor Distribution, Labor Cost Accounting, Payroll Preparation and Payment, and Labor Transfers and Adjustments. Therefore, DCAA needs to increase its testing of direct and indirect labor costs during other engagements to ensure that the Government reimbursed the contractor only for allowable costs. (Assignment Number 3191-2009F13010001)
- In an examination engagement of a billing system that processed \$4.3 billion, the auditor did not test internal controls for a key control objective, Implementation of Policies and Procedures. DCAA determined that the contractor's billing system was inadequate; therefore, the contractor cannot bill the Government without DCAA provisionally approving cost vouchers. However, failure to identify all potentially significant system deficiencies further delays the contractor implementing an adequate billing system. (Assignment Number 2641-2009C11010001)
- In an examination engagement of an indirect and other direct cost system that processed \$708 million, the auditor inappropriately relied on testing performed in other engagements for key control objectives. The auditor did not verify that the referenced engagements contained sufficient testing for the Preparation of Indirect and Other Direct Cost Submissions, Identification of Unallowables, and Allocability of Indirect and Other Direct Costs control objectives. Our review of the other engagements disclosed that sufficient appropriate testing for those control objectives was not performed in the referenced engagements and is not generally performed in those types of engagements. The audit office will need to significantly increase its testing of indirect and other direct costs on all engagements performed at this contractor. (Assignment Number 1721-2009B14980001)
- During the control environment system examination engagement<sup>33</sup> of a contractor with \$674.4 million in FY 2009 Government sales, the auditor identified that the contractor was not including the mandatory disclosure clause in its subcontracts and may not be performing periodic compliance reviews of its code of business ethics and conduct. Failure to perform either action, as required by Federal Acquisition Regulation Subpart 52.203-13, reflects on the contractor's attitude toward its required responsibilities to identify and disclose violations of laws and to establish an overall ethical business environment. Therefore, the potential non-compliances identified in the engagement should be considered a fraud indicator and should significantly increase the fraud risk when performing other examination engagements. The auditor did not perform additional work to fully develop and report the findings. Instead, audit office management decided to

---

<sup>33</sup> DCAA combines the reviews of the accounting system and the overall control environment system in one standard audit program. The audit office decided to perform only the overall control environment system review in the assignment we reviewed.

issue the report in February 2010 with an overall inadequate opinion based on other identified deficiencies and address the additional issues in a supplemental report. However, the audit office did not perform the additional work and, in response to our inquiry, stated that they would start a follow-up assignment by December 31, 2011. During the time period since the report was issued, the audit office canceled three accounting system reviews, any one of which could have covered the additional work needed on the control environment. DCAA should complete the work required to develop and report all significant control environment system deficiencies in a timely fashion. Deficiencies identified in a contractor's control environment impact the amount and type of testing performed on all engagements involving the contractor. (Assignment Number 3311-2008C11070001)

### ***Revised DCAA Approach for Internal Control System Reviews***

In FY 2010, based on a previously proposed revision to the Defense Federal Acquisition Regulation Supplement<sup>34</sup> and the legislative requirements regarding contractor business systems, DCAA began to restructure the internal control reviews it performed, drafted new audit programs, and started testing new audit programs for evaluating internal controls at 11 pilot sites. DCAA combined the planning and budgeting system review with the estimating system review; the compensation system and indirect and other direct cost system in the incurred costs audits; and the control environment, accounting system, billing system, labor accounting system, and information technology system in the accounting system review.

In March and April 2012, DCAA issued guidance revising its approach for reviewing major contractors' internal control systems. Significant changes included reducing from 10 to 6 the number of internal control systems subject to evaluation; opining on the contractor's compliance with the Defense Federal Acquisition Regulation Supplement regulation criteria for each system,<sup>35</sup> and issuing a deficiency report when sufficient evidence is obtained to support that a significant deficiency or material weakness exists. A February 24, 2012 Defense Federal Acquisition Regulation Supplement rule<sup>36</sup> implemented the following statutory requirements:<sup>37</sup>

- established a "Contractor Business System" clause defining contractor business systems as the contractor's accounting system, estimating system, purchasing

---

<sup>34</sup> Defense Federal Acquisition Regulation Supplement Case No. 2009-D038, "Business Systems-Definition and Administration," originally published in the Federal Register on January 15, 2010, with the revised rule published on December 3, 2010.

<sup>35</sup> Previously, DCAA opined on the effectiveness of the contractor's internal controls or the adequacy of the contractor's business systems.

<sup>36</sup> The Defense Acquisition Regulation Council previously issued an interim rule implementing the statutory requirements on May 11, 2011.

<sup>37</sup> Section 893 of the 2011 National Defense Authorization Act established requirements for the improvement of contractor business systems to ensure that such systems provide timely, reliable information for the management of DOD programs.

- system, earned value management system, material management and accounting system, and property management system;
- defined an acceptable business system based on detailed criteria for each system; and
- defined significant deficiency.

Proper implementation of the revised approach to performing internal control reviews could increase GAGAS compliance on these engagements and compliance with GAGAS 6.10 and 6.11 on other engagements. We have not reviewed the implementation of this revised approach; however, we will monitor improvement in this area through our continuous oversight of DCAA.

## **Documentation**

### ***Documentation Needs Improvement***

In 32 of the 47 examination engagements, the auditor did not comply with GAGAS and DCAA requirements for documentation. Specifically, the auditor did not adequately document the work performed to support significant judgments and conclusions, including descriptions of transactions and records examined. GAGAS 3.38 requires that auditors document significant decisions affecting the audit objectives, scope, and methodology; findings; conclusions; and recommendations resulting from professional judgment. Furthermore, GAGAS 6.20 requires auditors to prepare attest documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed, including the nature, timing, extent, and results of engagement procedures performed; the evidence obtained and its source; and the conclusions reached. Inadequate documentation hinders adequate supervisory review, other management reviews, and implementation of key quality control procedures. Additional time is also required by the audit staff and management to correct identified deficiencies thus delaying report issuance and work on other assignments. It also negatively impacts other future engagements when auditors inappropriately rely on the work performed. Finally, when engagement documentation is disordered, hard to follow, or contains errors or omissions, the work performed will not stand on its own when challenged. In the extreme, contracting officers or other users do not use the information provided and stop requesting audit services. This results in the Government's interests not being fully protected.

### ***Insufficient Documentation***

In 24 of the 47 examination engagements reviewed, the auditor did not provide sufficient detail in the working papers. GAGAS 6.21 requires auditors to prepare documentation in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand from the documentation the nature, extent, and results of procedures performed; the evidence obtained and its source; and the auditors' significant judgments and conclusions. Examples of documentation not providing sufficient detail included:

- In a \$12.9 million cost-type price proposal examination engagement, the auditor did not sufficiently document and reference the work performed, including evidential matter obtained, to support the cost questioned. We replicated the auditor's work to verify the questioned cost calculation. In addition, many working papers did not contain the DCAA-required on-page notes needed to explain the work performed. The auditor used an Eastern Region electronic working paper program, Proposal Evaluation and Reporting System, to construct spreadsheet documents to support the work performed. The spreadsheet produced by the program did not contain referenced notes and did not clearly show the recommended rates because the rates were not referenced back to source documents. (Assignment Number 1461-2010D21000003)
- During an examination of a \$164,295 partial termination of a \$1.3 million firm-fixed-price contract, the auditor did not document work performed in the detailed working papers and the working papers were very difficult to follow. Some working papers did not clearly explain the items tested, and others did not describe the supporting documentation used to accept the proposed costs. The auditor also referenced work to e-mail messages with folder attachments containing the supporting documentation; however, the referenced data were not readily identifiable in the e-mail attachments. (Assignment Number 1241-2009A17100003)
- In a \$222.5 million firm-fixed-price proposal examination engagement, some detailed working papers did not have the purpose, source, scope, and conclusion sections required to provide an explanation of the work performed. (Assignment Number 2801-2009G21000041)
- In a \$98.8 million firm-fixed-price proposal examination engagement, the auditor did not properly document questioned labor costs. Documentation of the work performed did not provide a clear understanding of the calculation of \$337,747 in questioned labor costs. The reviewer needed to discuss the assignment with the auditor to determine that the calculation was acceptable. (Assignment Number 9861-2009P21000019)

### ***Inadequate Documentation of Objectives, Scope, and Methodology***

In nine examination engagements, the auditor did not adequately document the objectives, scope, or methodology. GAGAS 6.22a requires auditors to do so, including descriptions of transactions and records examined. Inadequate documentation of sampling plans is a repeat deficiency identified in our prior review of the FY 2006 DCAA quality control system. Examples included:

- In a \$3.7 million multi-year incurred cost examination engagement, the auditor did not properly document the nonstatistical sampling plans used to perform transaction testing. The auditor did not describe the universe from which the items were selected or document how the nonstatistical selections result in adequate coverage of the universe to meet the engagement objectives. DCAA guidance requires this documentation in the working papers. (Assignment Number 3201-2007G101000230)

- In a \$1.6 million incurred cost examination engagement, the auditor did not properly document the nonstatistical sampling plans used to perform transaction testing. The auditor did not quantify the proportion of the universe selected and tested to show adequacy of coverage to meet the objectives as required by DCAA guidance. (Assignment Number 2161-2006P10100005)

### ***Inadequate Documentation of Work Performed***

In 28 of the 47 examination engagements reviewed, the engagement documentation did not adequately support the conclusions. GAGAS 6.22b requires auditors to document the work performed to support significant judgments and conclusions. Examples of inadequate documentation included:

- In a \$102.3 million incurred cost examination engagement, the final report did not tie to the draft report or summary working paper. The auditor explained that the final report was updated to correct executive compensation questioned costs. However, the auditor failed to update the working papers to provide the required supporting documentation for the questioned cost in the final report. (Assignment Number 6151-2007N10100001).
- In a \$151.7 million incurred cost examination engagement, the auditor did not document a \$29,400 downward adjustment of the questioned executive compensation costs. The auditor documented in the working papers \$223,849 of questioned executive compensation costs based on an analysis performed by the Mid-Atlantic Regional Compensation Team, but the final report questioned \$194,449. The auditor stated the difference was due to the contractor providing further analysis of claimed executive compensation; however, the auditor failed to document the analysis in the working papers. (Assignment Number 9851-2005F10100014)

Adequate supervision and management review of the reported findings is not assured when updated findings are not properly documented in the working papers.

## **Fraud, Illegal Acts, Violations of Provisions of Contracts, or Abuse**

### ***Inadequate Planning to Address Potential Fraud Indicators***

In 31 of the 47 reviewed examination engagements, DCAA did not comply with GAGAS requirements to identify and address potential fraud indicators during the planning process. Therefore, the audit offices did not identify all potential areas of fraud or abuse in the 31 engagements. GAGAS 6.13a requires the auditor to design the engagement to provide reasonable assurance of detecting fraud, illegal acts, or noncompliance with the provisions of contracts that could have a material effect on the assertion or subject matter and document the related risk factors. When risk factors are identified, the auditor should document the risk factor identified, the auditor's response to the risk factor, and the auditor's conclusions. For instance:



- In a defective pricing examination engagement of a \$22.7 million contract, the auditor documented that no fraud indicators were identified. However, the auditor did not address fraud risk factors related to compliance with the Truth in Negotiations Act and the specific contract being reviewed. In the risk assessment, the auditor used a contractor-provided estimate at completion worksheet to identify the risk factor that profit at completion would be significantly higher than negotiated. The auditor also noted that DCAA issued multiple positive defective pricing reports on the contractor. Both are fraud indicators for defective pricing. However, the auditor failed to design steps to address the profit issue. At a minimum, the auditor should have discussed the reason for the increased profit with the contractor and then used that information to design appropriate probe tests. In addition, because the auditor did not specify the nature of the previous defective pricing findings, they could not determine the significance of the prior findings to the current engagement or what steps should be performed to cover any relevant risk factors. (Assignment Number 6341-2008D42000026)
- In the risk assessment for a 2007 incurred cost examination engagement of a contractor with approximately \$300 million in Government sales, the auditor noted that a fraud referral was issued for potential labor mischarging during the prior year's engagement and the contractor was under investigation. However, contrary to those facts, the auditor documented for the fraud risk assessment step that no fraud risk indicators were disclosed during the preliminary audit steps. The auditor failed to document the nature of the mischarging, any relevant steps needed for the current engagement, or whether the already planned procedures adequately addressed the labor mischarging previously referred for investigation. (Assignment Number 6151-2007N10100001)
- During the examination engagement of a \$1.2 million contract, the auditor did not design procedures to specifically follow-up on significant prior findings, including costs transferred from task orders with no available funding to task orders with funding. The contractor did not have acceptable supporting documentation, a proper explanation or justification, or corrected time sheets for the transferred costs. The supervisor was also aware that the audit office had issued a fraud referral on labor transfers based on a prior year's incurred cost examination engagement. Additional procedures to consider included verification of any cost adjustment back to source documents for task orders with costs over the contract ceiling. (Assignment Number 1661-2009H17900002)
- During the performance of a labor system examination engagement at a major segment of a top 10 Defense contractor, the auditor requested and received a contractor internal audit report, but did not follow-up on the issues and recommendations identified for untimely submittal of timecards and lack of valid work authorizations. The contractor internal audit department categorized these deficiencies as important and requiring high priority attention by management. However, DCAA did not consider the significance of the contractor internal audit results and recommendations, expand completed compliance testing, or perform additional procedures to adequately cover the issues. (Assignment Number 3191-2009F13010001)

## ***Potential Fraud Risks Not Reported as Required***

In two examination engagements, the audit office was aware of potential fraud, illegal acts, or abuse but did not report it to outside parties. The appropriate authorities did not have the opportunity to determine whether to pursue the potential fraud criminally, civilly, or administratively. GAGAS 6.40 provides that the auditor should comply with legal requirements to report known or likely fraud, illegal acts, violations of contract provisions, or abuse to outside entities. DCAA is required to report such instances to the appropriate Government investigative organization. The two engagements identified were:

- During an incurred cost examination engagement that identified \$3.8 million in questioned indirect expenses, the auditor failed to submit a fraud referral for the contractor repeatedly claiming expressly unallowable costs despite documented guidance from the detachment audit manager that a fraud referral should seriously be considered. (Assignment Number 9851-2005F10100014)
- In a pre-award accounting system examination engagement of a small contractor, the auditor obtained sufficient evidence indicating the contractor was charging and billing excessive hours for employees, and was improperly billing consultants as employees. However, the auditor did not identify these issues as fraud indicators and refer the potential fraud. (Assignment Number 6431-2009B17740013)

## ***Current DCAA Guidance Should Be Revised to Increase Coverage of Fraud Indicators***

Current DCAA guidance is not sufficient to ensure that examination engagements comply with requirements related to detection, identification, and reporting of potential fraud, illegal acts, or abuse. Insufficient planning, risk assessment, and design of tests related to fraud, illegal acts, violations of contract provisions, and abuse is a repeat deficiency identified in our May 2007 report on the FY 2006 DCAA quality control system. DCAA nonconcurred with our previous recommendation that it enforce its guidance requiring audit offices to discuss potential fraud risks during the annual planning discussion with contractor representatives. Instead, DCAA determined that the AICPA requirement that it based its guidance on only applied to financial statement audits and, therefore, DCAA eliminated the requirement.

From August 2011 through June 2012, DCAA incorporated a revised fraud risk assessment procedure in its standard audit programs for examination engagements. The brainstorming procedure requires the audit team (managers, supervisors, and auditors) to discuss the risk of fraud for that engagement and to discuss the risk of fraud throughout the engagement. It also involves designing procedures to address the identified fraud risks to provide reasonable assurance of detecting fraud and other noncompliances with applicable laws and regulations that could have a material effect on the contractor's assertion. However, at the time DCAA revised its standard programs, DCAA did not

issue the standard DCAA guidance document<sup>38</sup> explaining the new process nor has DCAA included guidance on this process in its CAM. The guidance in CAM should explain the reason for performing the step and tie it to the applicable GAGAS and AICPA requirements. Additionally, since DCAA updated its computerized training course on Fraud Awareness in August 2011, it should reassess the course's coverage to determine whether revisions are needed to cover the team brainstorming process.

DCAA also does not require its audit staff to perform a step that many organizations find useful. As mentioned above, on July 16, 2007, DCAA eliminated the requirement for its auditors to make inquiries of contractor management of management's knowledge of fraud risks during its annual planning meeting with major contractors. Under commonly followed guidance, issued in 1992 and updated in 1994, by the Committee on Sponsoring Organizations<sup>39</sup>, a key component of a company's internal control framework is a risk assessment process to identify and analyze the internal and external risks to achieving its business objectives, including compliance with applicable laws and regulations. Also many Government contracts<sup>40</sup> issued after December 12, 2008 contain Federal Acquisition Regulation 52.203-13(c)(2)(ii)(C) clause requiring the contractor to periodically evaluate and assess the risk of criminal conduct and modify its internal controls and compliance programs as necessary to address that risk. Thus a responsible contractor should already be assessing the risks of fraud, illegal acts, and noncompliances with applicable laws impacting Government contracts and be prepared to discuss the identified risks with DCAA. Such discussions would be beneficial both on an annual basis and on specific engagements during the entrance conference. These discussions with management regarding fraud risk are already a requirement for financial statement auditors under AICPA AU 316 which is incorporated by reference into the GAGAS 2011 version<sup>41</sup> for financial audits. For attestation engagements, the GAGAS 2011 version does not directly incorporate the AICPA requirements. The management inquiry procedure represents a best practice that DCAA should incorporate in its standard fraud risk assessment process and instruct its audit staff to begin holding such discussions with contractor representatives immediately.

### ***Revised Finding and Recommendation***

As a result of management comments, we revised the draft finding on the GAGAS 2011 version requirement to discuss fraud risks with contractor management to clarify the

---

<sup>38</sup> DCAA normally issues an MRD to its audit offices explaining changes to its guidance and processes or procedures, or providing relevant information related to its audit work.

<sup>39</sup> The Committee on Sponsoring Organizations [COSO] was formed in 1985 to issue guidance on how companies could implement the Treadway Commission's recommendations designed to reduce the probability of fraud in financial reporting. The issued guidance defined internal control and five interrelated components of internal control which included control environment; risk assessment; control activities; information and communication; and monitoring.

<sup>40</sup> The contracting officer is to use this clause in Government contracts and subcontracts that are for more than \$5 million and have period of performance lasting 120 days or longer. Contracts for the acquisition of commercial items or that will be performed outside of the U.S. are exempt.

<sup>41</sup> The 2011 version of GAGAS is effective for financial audits and attestation engagements for periods ending on or after December 15, 2011.

requirement when performing attestation engagements. We also revised Recommendation 11.a to clarify the nature of the additional resources needed to assist auditors with their assessment of fraud indicators and determination of audit steps to address the indicators.

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

**11. Increase the effectiveness of and compliance with fraud-related standards by:**

- a. Developing a toolkit or guidance for auditors to use when assessing fraud risk indicators to determine which procedures or steps to include to address each fraud indicator identified during planning. It should also provide information on determining which steps to expand, include alternative steps to perform when more appropriate than expanding existing steps, and address any fraud indicator found during the execution phase of the engagement.**

### **DCAA Comments**

DCAA agreed in principle. DCAA stated that in June 2012, DCAA revised all applicable audit programs to include audit team discussions on fraud risk and other noncompliances that could have a material effect on the audit and the design of appropriate audit procedures. Stating that the current DCAA teaming approach that encourages critical thinking is a better approach, DCAA did not agree with providing auditors a “toolkit” of audit steps for each fraud indicator because it could lead to a “checklist mentality.” However, DCAA will assess the need for the enhancement of audit procedures related to fraud risk during an ongoing policy project on fraud by June 30, 2013.

### **Our Response**

DCAA comments did not fully address the intent of the recommendation. We agree that the recently implemented audit team discussions on fraud risk are a positive step to a more comprehensive fraud risk assessment process. This approach will not be fully effective without the proper resources to support the process. Thus, the intent of the recommended toolkit is to support and promote critical thinking by providing information to the auditor on the relationship between potential fraud indicators and audit procedures. The audit team would use this information during team discussions to ensure that indicators are properly addressed in both the planning and execution phases. DCAA should consider issuing guidance that provides examples on additional audit steps to be performed to address specific fraud indicators. We request that DCAA to provide additional comments on this recommendation in response to the final report.

- b. Revising guidance to include a revised fraud risk assessment procedure in which the audit team (managers, supervisors, and auditors) discusses the risk of fraud for that engagement and design procedures to address the identified fraud risks as required by government auditing standards.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that it revised all applicable audit programs in June 2012 to require audit team discussions on fraud risk and to design audit procedures to address the identified risks. DCAA concluded that based on the team discussions and the other risk assessment procedures, the audit team designs audit procedures to address identified fraud indicators. DCAA considers the actions taken to address this recommendation complete.

## **Our Response**

The DCAA comments were partially responsive to the intent of the recommendation. DCAA has revised all applicable audit programs to include audit team discussions on fraud risk. No guidance exists to explain the team discussion process or illustrate it. The audit team discussion approach differs decidedly from the prior fraud risk assessment step. Therefore, the audit team needs appropriate guidance to ensure its effective implementation. DCAA normally issues guidance documents when making process improvement changes. We request that DCAA reconsider issuing relevant guidance to support its revised fraud risk assessment process and provide comments on the final report.

- c. Revising guidance and all applicable standard audit programs to require the audit staff to ask pertinent questions of appropriate level contractor personnel regarding the contractor's assessment of fraud risks relating to the assertion or subject matter of the engagement.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that the American Institute of Certified Public Accountants AT 601.33, which is incorporated into GAGAS for attestation engagements, does not include the requirement to inquire of company management about its assessment of fraud risk. However, DCAA will consider including this requirement and others on fraud as referenced in the AICPA auditing standards but not required by the AICPA attestation standards in its policy project on fraud and assess whether enhancements to fraud risk guidance are needed by June 30, 2013.

## **Our Response**

The management comments were partially responsive to the intent of the recommendation. Asking contractor management about its assessments of the risk of fraud in its business operations impacting government contracts represents a best practice. We agree that inquiring of management about its fraud risk assessments is not a GAGAS requirement for attestation engagements. Performing management inquiries,

however, will enhance the effectiveness of designing the audit to detect instances of fraud material to the engagement, which is a GAGAS requirement. Certified Public Accountants are required by auditing standards to make management inquiries about fraud risk in performing audits to protect stockholder interests. DCAA should incorporate the same requirement when performing contract audits of Defense contractors to protect taxpayer interests. We revised this report section to clarify the GAGAS reference to AICPA auditing and attestation standards' requirements. We request that DCAA strongly consider adding this requirement to its fraud risk assessment process as they complete the fraud policy project. DCAA should provide comments on the final report.

- d. Assessing the August 2011 version of the Fraud Awareness training course to determine whether it covers all DCAA required processes associated with identification, detection, and reporting of potential fraud and revise the course, as needed, to provide such coverage.**

## **DCAA Comments**

DCAA agreed stating that DCAA would assess its Fraud Awareness training course and revise it, as needed, for any changes in guidance by December 31, 2013.

## **Our Response**

DCAA comments were responsive. The Fraud Awareness training course is DCAA's primary training vehicle on fraud and auditor responsibilities regarding fraud when performing audits. If possible, DCAA should complete this action by June 30, 2013. No additional comments are required.

## **Supervision**

### ***Ineffective Supervision***

For 38 of the 47 examination engagements reviewed, supervision was ineffective to ensure that work performed met standards. GAGAS 6.04a states that the supervisor must properly supervise any assistants [auditors]. Supervision involves reviewing the work performed to ensure that it was adequately performed and supports the report conclusions. Supervisors should also review the work performed to verify that it complies with GAGAS. For most engagements reviewed, the supervisor documented initial, interim, and final reviews as required by DCAA procedures. However the pattern of multiple noncompliances with planning, communication, evidence, documentation, and fraud-related standards clearly indicates that supervision was inadequate. Inadequate or ineffective initial, interim, and final supervision directly led to the significant number, 74 percent, of assignments reviewed that demonstrated a lack of professional judgment.

We also identified 10 of 47 reviewed examination engagements with deficiencies in supervisory documentation. The DCAA electronic audit assignment software generates standard documents for the supervisor to document approval of planned steps, initial

guidance, interim review, and final reviews. Examples of documentation deficiencies included:

- In six examination engagements, final supervisory review comments were either not made or the comments were generally administrative in nature and did not provide guidance to correct GAGAS-related deficiencies. (Assignment Numbers 6431-2009B17740013; 2641-2009C1101001; 3191-2009F13010001; 3521-2009C21000011; 6381-2009G11590001; and 1461-2010D21000003)
- In two examination engagements, the supervisory auditor either did not provide adequate initial guidance prior to the auditor completing the risk assessment or did not provide interim review comments. (Assignment Numbers 4901-2008W17900010 and 4261-2009T27000040)
- In one examination engagement, the supervisor did not approve the initial audit plan. (Assignment Number 6151-2007N10100001)
- In one examination engagement, the supervisor did not approve the sample plan prior to its implementation. (Assignment Number 9731-2007B10100017)

Six of the above examples of deficiencies in supervisory documentation were identified on engagements where DCAA did not demonstrate professional judgment. The supervisory documentation deficiencies we identified combined with supervisors' failures to identify significant deficiencies in the work they were responsible for reviewing indicate that DCAA supervisors could be filling in the required standard forms in a perfunctory manner. DCAA should consider whether changes to the standard supervisory administrative documents would help improve the effectiveness of supervisory reviews, especially for newly promoted supervisors.

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

- 12. Improve the effectiveness of supervisory auditors and compliance with government auditing standards by:**
  - a. Revising existing standard electronic working papers that supervisory auditors use to document supervisory guidance and review to address specific government auditing standards and Defense Contract Audit Agency guidance requirements;**
  - b. Providing additional tools such as a link to suggested potential corrective actions to remedy any identified deficiencies, and reminder checklists directly linked to the electronic working paper packages for supervisory auditors to use as aids when reviewing assignments.**

- c. **Moving the audit guidance on performing and documenting supervisory reviews from the Defense Contract Audit Agency Contract Audit Manual to a location or source directly linked to the electronic working paper packages so that the information is more readily available to users.**

## **DCAA Comments**

DCAA agreed in principle with the recommendations. DCAA stated that it has taken steps to improve the effectiveness of supervisory auditors in complying with GAGAS through training and other initiatives that help supervisors understand their responsibilities under the standards and DCAA policy. DCAA also stated that it required all supervisory auditors to attend a training course that addressed supervisory responsibilities in FY 2011. Additionally, the DCAA Integrity and Quality Assurance Directorate provided the Supervisory Auditor Assignment Review Process Workshop to give all supervisors training on reviewing working papers. DCAA also initiated a coaching program to assist supervisors in performing their duties. DCAA disagreed with providing supervisory auditors with suggestions and reminders because it could lead to a “checklist mentality” and inhibit the critical thinking skills needed to determine the appropriate corrective actions for specific circumstances. DCAA considers the actions related to the intent of these recommendations complete.

## **Our Response**

DCAA comments were generally responsive. No additional comments are required. As part of our followup and monitoring responsibilities, we will consider whether the training and other initiatives are sufficient to maintain and continue to improve supervisory skills.

## **Reporting**

### ***DCAA Reports Did Not Comply with GAGAS Requirements***

In 34 of the 47 examination engagements, the report did not comply with GAGAS reporting standards. Generally, the reports did not comply with GAGAS because the evidence obtained was not sufficient to support the report conclusions. GAGAS 6.04b states that auditors must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in the report. Some reports also should not have been issued because the report did not include appropriate qualifications, and the report conclusions were not consistent with the draft report and supporting working papers. A summary of significant deficiencies identified are detailed in Table 6 below.

**Table 6. Summary of Identified Reporting Noncompliances with GAGAS and DCAA Policies**

<b>Cite</b>	<b>Requirements</b>	<b>Summary of Finding</b>
GAGAS 1.12b	Auditors should include a modified GAGAS compliance statement in reports on GAGAS attestation engagements, as appropriate if the	In one examination engagement, a review of direct costs claimed on flexibly priced contracts, the auditor did not include the required “GAGAS Peer Review



Cite	Requirements	Summary of Finding
	auditor was unable to and did not perform the attestation engagement in accordance with GAGAS.	Qualification Statement” in the February 9, 2010 report. The DCAA Director issued a memorandum to all DCAA employees instructing them to include a modified GAGAS statement in the scope paragraph for all reports issued on or after August 27, 2009 because the DOD Inspector General opinion on the DCAA quality control program expired as of that date. (Assignment No. 9731-2007B10100017)
<p>AT<sup>42</sup> 101.74</p> <p>Qualified Opinion: CAM<sup>43</sup> 10-210.4.d</p> <p>Access to Records: CAM 1-504.4.c and .d</p>	<p>The auditor’s decision to provide a qualified opinion, to disclaim an opinion, or to withdraw because of a scope limitation in an examination engagement depends on an assessment of the effect of the omitted procedure(s) on his or her ability to express assurance. The reasons for a qualification or disclaimer should be described in the auditor’s report.</p> <p>The Qualification paragraph should include circumstances that result in a qualified opinion. A qualification would arise from contractor deficiencies such as a lack of access to or inadequate contractor records.</p> <p>The following conditions qualify as an access to records problem: restrictions on reproduction of necessary supporting evidential matter, and partial or complete denial of access to internal audit data or other management reports on contractor operations.</p>	<p>In three examination engagements discussed below, DCAA did not properly address scope limitations or the needed report qualification. Failure to provide all relevant information in the report negatively impacts the contracting officer’s ability to appropriately negotiate or administer the contract(s).</p> <ul style="list-style-type: none"> <li>In a FY 2008 Control Environment examination engagement, DCAA did not include the appropriate report qualification for an access to records issue. The contractor provided the 85 contractor hotline cases that DCAA requested; however, 80 of the 85 cases provided had the information redacted. The extensive redactions eliminated critical information required by the auditor. This created an access to records issue in accordance with DCAA guidance that the auditor should have recognized as such and qualified the report accordingly. (Assignment No. 3311-2008C11070001)</li> </ul>

<sup>42</sup> The AICPA uses the designation of “AT” to reference the various attestation standards. The attestation standards referenced in this table are ones which GAGAS incorporates by reference.

<sup>43</sup> DCAA provides guidance to its auditors in its CAM. CAM references indicate what specific guidance DCAA has issued to implement the corresponding GAGAS or attestation standards.

Cite	Requirements	Summary of Finding
<p>Floor Checks: CAM 10-504.3.b</p>	<p>If labor floor checks or interviews were considered necessary to complete the audit [engagement] but could not be accomplished concurrently for the period audited, insert the following additional statement in the scope paragraph: “The concurrent verification of (indicate whether labor, materials or both) was omitted in this examination (if accomplished in at least one year of a multi-year examination, state fiscal years omitted).”</p>	<ul style="list-style-type: none"> <li>• In a FY 2006 incurred cost examination engagement that included \$500,456 in claimed total labor costs, the auditor did not qualify the report for lack of a labor floor check as required by DCAA guidance. The auditor also did not document the performance of additional steps as required by DCAA guidance when there is an omission of labor in the examination. In addition, the audit office failed to assess and describe in the report the impact of the omitted verification of labor costs on the engagement results. (Assignment No. 04171-2006G10100007).</li> <li>• In a FY 2006 incurred cost examination engagement that included \$50,221,659 in claimed labor costs, the auditor did not qualify the report for nonperformance of a labor floor check or non-receipt of a requested assist audit as required by DCAA guidance. The auditor documented during the planning phase that the report would be qualified due to the inability to determine the impact of the lack of performance of a labor floor check. (Assignment No. 3171-2006J10100002)</li> </ul>
<p>Assist Audits: CAM 10-504.3.b (see citation above) and CAM 10-504.4</p>	<p>The report should be qualified if the incurred cost audit included requests for assist audits on subcontract costs that were not received in time for incorporation in the final report. The procedure provides specific information that the report should include such as subcontract number, subcontractor name, claimed/billed amount for the subcontract, name of the audit</p>	<ul style="list-style-type: none"> <li>• In the same examination engagement, the audit office also did not qualify the report for non-receipt of a requested assist subcontract audit. Finally, the auditor did not qualify the report for two cost accounting standards’ noncompliances that related to several million dollars of independent research and development costs that were identified during the engagement.</li> </ul>

Cite	Requirements	Summary of Finding
	office performing the assist, and the expected due date for the assist audit report.	(Assignment No. 3171-2006J10100002)
GAGAS 6.34	Auditors should report significant deficiencies in internal control, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report data reliably in accordance with the applicable criteria or framework such that there is more than a remote likelihood that a misstatement of the subject matter that is more than inconsequential will not be prevented or detected.	In a budget and planning system examination engagement, the auditor did not identify a system deficiency regarding the lack of written policies and procedures. Without this information the contracting officer cannot take the appropriate action to have the contractor remedy the deficiency. A delay of this type also causes the Government to unnecessarily increase the amount of oversight needed of the contractor. (Assignment No. 4301-2009H11020002)
GAGAS 6.42	In presenting findings such as deficiencies in internal control, auditors should develop the elements of the findings to the extent necessary to achieve the objectives. GAGAS 6.15 through 6.19 describe clearly developed findings and include criteria, condition, cause, and effect or potential effect.	In a budget and planning system examination engagement, the auditor did not write the report using the proper format of condition, cause, effect, and recommendation. Contracting officers require all relevant information to achieve an acceptable resolution to the identified deficiencies and protect the Government's interests. (Assignment No. 4301-2009H11020002)
GAGAS 6.49	Auditors should evaluate the validity of the audited entity's comments when the contractor's comments are inconsistent or in conflict with the report's findings, conclusions, or recommendations, or when planned corrective actions do not adequately address the auditors' recommendations. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement.	In an indirect and other direct costs internal control system examination engagement, the contractor verbally disagreed with the findings. The auditor did not include the disagreement or address it in the final report. Failure to rebut all the contractor's arguments in the report could delay resolution or correction of the system deficiencies. It allows the contractor to argue the points directly with the contracting officer without the DCAA rebuttal being directly available. The contracting officer could decide the issues without contacting DCAA, assuming that DCAA has no rebuttal arguments since they are not reflected in the report. (Assignment No. 1721-2009B14980001)

Cite	Requirements	Summary of Finding
GAGAS 6.56a	Auditors should distribute copies of the reports to other officials responsible for acting on engagement findings and recommendations, and to others authorized to receive such reports.	<p>In two examination engagements, the report distribution section did not properly list all required recipients. The distribution list should act as an official record of who received the report.</p> <ul style="list-style-type: none"> <li>• In a price proposal examination engagement for \$417,610, the auditor did not list the DCAA headquarters financial liaison advisor in the report distribution section. DCAA policy states that financial liaison advisors are to receive forward pricing audit reports issued to the component they service. The report is to be distributed to the DCAA headquarters financial liaison auditor to facilitate the advisor answering contracting officer questions regarding the report contents. This is done so that negotiations can proceed expeditiously. (Assignment No. 6701-2010S27000002)</li> <li>• In an incurred cost examination engagement at a contractor with \$149 million in revenue, the auditor did not list the applicable non-DoD agencies in the report distribution section even though the audit office specified the use of the non-DoD regulation supplements as criteria in the scope of audit section of the report. Therefore, either the appropriate non-DoD agencies did not receive the report or the audit office incorrectly used non-DoD regulations as criteria when performing and reporting on the engagement. (Assignment No. 3171-2006J10100002)</li> </ul>

DCAA should assess its guidance on including qualifications in its reports for compliance with GAGAS. The current guidance, as referenced in the cases above, does not provide

guidance on when and how to add a modified GAGAS compliance statement in the report. GAGAS 1.12b specifies “...Situations when auditors use modified compliance statements include scope limitations, such as restrictions on access to records, government officials or other individuals needed to conduct the audit.” GAGAS 1.12b also requires certain information be included in the report when using a modified GAGAS statement which includes:

- the applicable requirements not followed;
- the reasons for not following the requirements; and
- how not following the requirements affected, or could have affected, the engagement and the assurance provided.

DCAA should also review the implementation of its guidance to determine whether auditors are identifying all applicable situations that require report qualifications, especially those related to access to records issues. Auditors should still qualify reports for access to records issues even when court decisions limit DCAA’s legal right to have certain documents. For instance, DCAA interprets two 1988 Fourth Circuit Court of Appeals decisions<sup>44</sup> as holding that language in the statutes giving DCAA access to contractor’s books and records did not generally include internal audit reports unrelated to a specific contract or proposal. However, in certain engagements such as the Overall Control Environment and Accounting System review or a labor audit, contractor internal audit reports and the associated working papers contain vital information. Therefore, when the audit office determines that information is needed to comply with GAGAS, then the report should be qualified accordingly and the qualification properly explained. The key issue is whether the auditor determined that the information, records, or data obtained through interviews was needed to form their opinion.

## **Written Reports Not Distributed in a Timely Manner**

In 20 examination engagements, DCAA did not issue the report in a timely manner. CAM 10-103.1 requires that reports to be issued on or before the dates specified and, in any event, as promptly as possible. DCAA guidance also provides that when a specified reporting date does not allow sufficient time to perform a complete audit, the auditor should request a time extension. When the extension is granted, it should be confirmed in writing. To be useful, the report must be timely. Delays in issuing certain reports such as system reviews and operations audits also result in use of additional auditor time, sometimes further delaying the report issuance. The auditor has to perform additional work to update findings which would not have been required if the report was issued promptly. Untimely reports or the failure to properly coordinate report due date extensions also negatively impact the contract negotiation or administration timeline. Examples included:

- An accounting system report with an inadequate system opinion was issued

---

<sup>44</sup> *United States v Newport News Shipbuilding and Dry Dock Company*, 837 F.2d 162 (4th Cir. 1988) and *United States v Newport News Shipbuilding and Dry Dock Company*, 862 F.2d 464 (4th Cir. 1988).

19 months after the entrance conference was held. The significant reporting delay allowed the accounting system status to remain adequate based on the previous 2006 engagement. In addition, the delay impeded the contracting officer from taking action to affect timely correction of the deficiencies. (Assignment Number 3311-2008C11070001)

- For an incurred cost examination engagement, the contracting officer was notified of the start date of the engagement, but not informed of significant delays. The report was issued 3 years later. This delayed the resolution of \$3.8 million in questioned overhead costs, a decrease of 2.9 percent in the overhead rate. (Assignment Number 9851-2005F10100014)
- A report on proposed FY 2009 forward pricing rates was issued 3 months after the end of FY 2009 and about 10 months from the requested date. Thus DCAA's recommendations for questioned indirect rates could not be implemented in related 2009 contracting actions. (Assignment Number 4181-2009A23000002)
- In some examination engagements, when the DCAA auditor requested an extension of a due date, the report was still issued 7-10 days after the extended due date with no explanation or follow-up notification in the working paper file. The delays potentially impacted the contracting officer's negotiation plans or schedules or made the reports irrelevant when the contracting officer decides to proceed without the report.

## **Recommendations, Management Comments, and Our Response**

### **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

- 13. Revise existing guidance on reporting scope limitations or qualifications to comply with generally accepted government auditing standards paragraph 1.12b and American Institute of Certified Public Accountants AT 101.74 requirements.**

### **DCAA Comments**

DCAA agreed in principle stating that the DOD IG findings were not exceptions to guidance, rather implementation issues. DCAA stated that scope limitations and appropriately qualifying reports were addressed during the Training Initiative on Performing Quality Audits discussed in response to Recommendation 2. DCAA considers the actions taken to address the intent of the recommendation to be complete.

### **Our Response**

DCAA comments did not address the intent of the recommendation. We agree that providing training on reporting scope limitations or qualifications should improve compliance with the standards; however, DCAA did not address whether its existing guidance complies with GAGAS 1.12b and AICPA AT 101.74. We request that DCAA

provide comments on the final report specifying the action it will take to ensure its guidance is compliant.

- 14. Revise existing training to emphasize to the audit staff the importance of including the effect of any access to records issue on the engagement in the applicable report.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that the Defense Contract Audit Institute Course 6115, Effective Report Writing, that is required for all auditors in their second year with DCAA, includes a handout of DCAA Instruction 7640.17, “Formal Reporting Procedures for Denial of Access to Contractor’s Records.” The topic also was covered under the Training Initiative on Performing Quality Audits discussed in response to Recommendation 2. DCAA considers the actions to address this recommendation complete.

## **Our Response**

DCAA comments were responsive. No additional comments are required.

- 15. Issue a memorandum to the audit staff re-emphasizing the importance of including the effect of any access to records issue on the engagement in the applicable report.**

## **DCAA Comments**

DCAA agreed in principle. DCAA stated that all DCAA audit staff received training on scope limitations and denial of access to records during the Training Initiative on Performing Quality Audits provided from December 2010 and April 2011. DCAA considers the actions taken to address the intent of this recommendation complete.

## **Our Response**

DCAA comments were responsive. No additional comments are required.

# **Agreed-Upon Procedures Engagements**

## **Inadequate Planning and Performance**

DCAA did not exercise professional judgment in planning and performing the two agreed-upon procedures engagements we reviewed, Assignment Numbers 4141-2009B28000001 and 4601-2010S28000001. The difference between performing an agreed-upon procedures engagement and other attestation engagements is that the requester takes responsibility for defining the procedures to be performed during the engagement. AT Section 201.03 defines an agreed-upon procedures engagement as one in which the auditor is engaged by a client to issue a report of findings based on specific procedures performed on the subject matter. The auditor assists the specified parties in evaluating the subject matter or an assertion based on the specified parties’ needs.

Therefore, obtaining all specified parties' (requester and users) agreement with the specific procedures to be performed and properly defining the agreed-upon procedures to be performed are key factors to complying with GAGAS and the AICPA standards. In the two reviewed engagements, DCAA met neither requirement. Because the two reviewed agreed-upon procedures engagements were planned and performed as assist audits<sup>45</sup> for other DCAA offices, DCAA failed to obtain this agreement with the original requesters. The agreed-to procedures that DCAA auditors performed also were not adequately defined or did not otherwise meet AICPA requirements. This is a repeat finding from a report previously issued on May 1, 2007. Our review also identified other deficiencies in auditor communication during planning and obtaining evidence. Based on the deficiencies identified, neither report should have been issued.

### ***DCAA Assist Audits Performed Without Obtaining All Users' Agreement***

DCAA planned and performed both reviewed agreed-upon procedures engagements as assist audits for another DCAA audit office. AT 201.03 defines specified parties to include the requester who has engaged the auditor to assist the specified parties in evaluating an assertion or subject matter based on the identified specified parties needs. Additionally, AT 601.16<sup>46</sup> explains that the objective of an agreed-upon procedures engagement is to present specific findings to assist users in evaluating an entity's compliance with specified requirements. In both engagements, the original requester was also a specified party to the assist audit since the original requester was the end user of the work performed under the assist audit. AT 201.07 and AT 601.18 state that the auditor should ordinarily communicate directly with all specified parties or users to obtain an affirmative acknowledgement on the procedures to be performed from each of them. AT 201.11 emphasizes that the requester and other users, the specified parties, are responsible for the sufficiency of the agreed-to procedures because they best understand their own needs. In neither engagement did the audit office performing the assist audit obtain agreement on the procedures to be performed from the original requester. The DCAA audit office that requested the assist audit also did not obtain the original requester's agreement on the procedures. Because the requester and other users assume the risk that the procedures might be insufficient for their purposes, it is especially important that the end user understand and agree to the procedures to be performed. According to AT 201.07 and AT 601.18, the auditor should not report on an engagement

---

<sup>45</sup> Assist audits refer to the situation where one DCAA auditor at one location is furnished assistance in the form of a GAGAS-compliant engagement or audit by a DCAA auditor at another location. DCAA audit offices perform work at contractor locations within a defined geographic location and a prime contractor may include costs not supported by the books and records maintained at its geographic location. DCAA audit offices generally perform assist audits on subcontracts, offsite labor, or on costs which are allocated from or to records which are maintained at home offices, other divisions, segments, cost centers, etc. The DCAA audit office cognizant of the prime contractor is responsible for identifying the elements of cost requiring assist audits and requesting the assist audits.

<sup>46</sup> DCAA generally follows AT Section 601, Compliance Attestation, when performing its attestation engagements. AT 601 provides requirements in addition to the general requirements specified in AT Sections 20, 50, 101, and 201.



when specified parties or specified users do not agree on the procedures to be performed and do not take responsibility for the sufficiency of the procedures for their purposes. DCAA should not have performed the two assist audits as agreed-upon procedures engagements using the existing DCAA guidance.

### ***Noncompliance with Requirements to Define Procedures***

The procedures that DCAA agreed to perform in both engagements did not comply with the AICPA definition or criteria for acceptable procedures for this engagement type. AT 201.15 and AT 601.17 recognize that the procedures that the auditor and specified parties or users agree to may be as limited or as extensive as the specified parties desire. However, the standards require that certain criteria be met. Table 7 below summarizes the various deficiencies our review identified in the two reviewed engagements relating to the relevant standards. The identified deficiencies are similar to noncompliances reported on in our May 1, 2007 report discussed below.

**Table 7. Deficiencies in Defining the Procedures to Be Performed**

Assignment Number	Deficiency Identified
4141-2009B28000001	<p>Neither of the two agreed-upon procedures performed in this engagement complied with the standards' requirements.</p> <ul style="list-style-type: none"> <li>• Procedure 1 did not define 'available' which was used as criteria in the agreed-to procedure. AT 201.16 provides that the auditor should not agree to perform overly subjective procedures that are possibly open to varying interpretations. Terms of uncertain meaning should not be used in describing the procedures unless the terms are defined within the procedure. Procedure 1 did not comply with this requirement.</li> <li>• Procedure 1 also did not include a time period. AT 201.15 requires that the nature, timing, and extent of the procedures be agreed to. The time period to be covered by the procedure is critical to the finding's usefulness to the requester and other users.</li> <li>• Procedure 2 only required the auditor to provide the requester with specific backup documents. AT 201.15 provides that a procedure cannot be just the reading of an assertion or specified information about the subject matter because performing this type of procedure does not produce results for the auditor to report on. Therefore, providing backup documentation is also not an acceptable procedure because this task also does not result in a finding for the auditor to report on.</li> </ul>
4601-2010S28000001	<p>The procedure performed in this engagement did not meet the standards for two reasons.</p> <ul style="list-style-type: none"> <li>• The criteria used to perform the procedure were not properly defined as required by AT 201.16 discussed above.</li> <li>• The auditor did not apply the agreed-upon procedures on the third quarter data submitted with the request, but instead used the fourth quarter forecast data the audit office obtained from the contractor component responsible for generating the data. Therefore, the</li> </ul>

Assignment Number	Deficiency Identified
	auditor did not have a formal agreement with all the users as to the time period to be covered by the agreed-to procedure as required by AT 201.15 discussed above. Because the assist audit covered fourth quarter data instead of third quarter data, its results did not cover the same time period as the audit of the prime contractor. This increased the end user's risk of misunderstanding or inappropriately using the information provided.

DCAA should ensure that the correct definition of the agreed to procedures is applied by its audit staff when performing agreed-upon procedures engagements to prevent misinterpretation or inappropriate use of the findings by users.

### ***Other Noncompliances Impacted the Usefulness of the Work Performed***

Our review identified other significant noncompliances in the two reviewed engagements that increased the users' risk that they might misunderstand or otherwise inappropriately use the findings reported by the audit offices. Table 8 below summarizes the identified deficiencies.

**Table 8. Other Noncompliances Identified in Reviewed Agreed-Upon Procedures Engagements**

Assignment Number	Noncompliance Identified
4141-2009B28000001	<ul style="list-style-type: none"> <li>The engagement did not comply with GAGAS 6.06 requirement to obtain written acknowledgement or other evidence of the entity's responsibilities for the subject matter or the written assertion as it relates to the objectives of the engagement. The DCAA assist audit request references a prime contractor's claim that the subcontractor costs met the Federal Acquisition Regulation exception for commerciality and attached a copy of a subcontractor invoice to identify the pertinent part. The auditor did not obtain the required written acknowledgement or other evidence of the subcontractor's responsibility for the written assertion as it relates to the engagement objectives. The prime contractor cannot take responsibility for a subcontractor's claim that a specific item complies with the regulatory exception for commerciality<sup>47</sup> because the commerciality</li> </ul>

---

<sup>47</sup> Federal Acquisition Regulation Subpart 2.101 defined a "commercial item" as any item, other than real property, that is of a type customarily used for nongovernmental purposes and that: (i) has been sold, leased, or licensed to the general public; (ii) has been offered for sale, lease, or license to the general public; (iii) has evolved from a commercial item that is sold or offered for sale as a result of technological advancement; (iv) requires either modification of a type that is customarily available in the commercial market place or minor modifications for unique Government purposes; or (v) any combination of the above items.

Assignment Number	Noncompliance Identified
<p>4141-2009B28000001 and 4601-2010S28000001</p>	<p>exception is based on sales data<sup>48</sup> that the prime contractor either does not have access to or control of. Proper identification of the assertion to be reviewed by the requester or the entity responsible for the assertion is required to ensure that the end user obtains the correct information.</p> <ul style="list-style-type: none"> <li>• The engagement also did not comply with the GAGAS 6.04b requirement to obtain sufficient evidence to support the report. Additionally, the engagement did not comply with AT 201.16 requirements to obtain evidential matter from applying the agreed-upon procedure to provide a reasonable basis for the finding(s) expressed in the report. The auditor did not verify or obtain sufficient evidence that the end users were not state, local, or Federal Government, or companies acting on behalf of the Government. Using these criteria is a key factor in determining whether an item qualifies for a commerciality exemption for submittal of certified cost or pricing data. The request specifically clarified the criteria to be used by including that definition for general public. Therefore, the contracting officer relied on inaccurate information during negotiations.</li> <li>• Neither engagement complied with the GAGAS 6.07 requirements to communicate, in writing, the auditor's understanding of the services to be performed to the appropriate officials of the entity's management. Our review also identified this noncompliance in all of the examination engagements we reviewed. Additional information on this noncompliance is provided in the 'Auditor Communication During Planning' section of this report.</li> </ul>

### ***Inadequate Implementation of DCAA Training on Agreed-Upon Procedures***

The audit staff who worked on both engagements did not take CMTL (Computer Managed Training Library) No. 1249, Agreed-Upon Procedures, prior to performing the agreed-upon procedures engagement. This training is required by MRD 08-PSP-030, "Audit Guidance on Agreed-Upon Procedures (AUP) Engagements," dated September 24, 2008. DCAA headquarters established this requirement after issuance of DOD IG Report Number D-2007-6-006 dated May 1, 2007, that identified similar deficiencies as those described. The identified deficiencies included:

- Failure to comply with key GAGAS or AICPA attestation standards as incorporated in GAGAS.

---

<sup>48</sup> Per Federal Acquisition Regulation Subpart 15.403-1(b), a contracting officer shall not require certified cost or pricing data to support a pricing action when a commercial item is being acquired.

- No evidence that the requester agreed to or accepted responsibility for the procedures performed.
- Criteria were not appropriately defined. Procedures were not appropriately defined.
- All reporting requirements were not met.

In response to the report findings and recommendations, DCAA also revised its guidance on performing agreed-upon procedures engagements and planned to continue monitoring this type of engagement until DCAA management was satisfied that compliance with GAGAS had improved. Prior to the establishment of the September 24, 2008 training requirement and while field work was ongoing, DCAA issued a November 9, 2006, memorandum that transmitted headquarters-provided training materials to assist regional and Field Detachment office staff to monitor agreed-upon procedures engagements. The training was to be completed by January 31, 2007.

Despite these initiatives, for the two reviewed agreed-upon procedures engagements, the audit offices did not comply with GAGAS 3.45 requirements that auditors should be knowledgeable of and be competent in applying the AICPA general attestation standard related to criteria, the AICPA attestation standards for field work and reporting, and the related Statements on Standards for Attestation Engagements. The audit staff did not collectively possess sufficient knowledge to perform the engagement. The lack of knowledge or training contributed to the audit offices not performing the agreed-upon procedures engagements correctly.

### ***DCAA Guidance on Agreed-Upon Procedures Needs Further Improvement***

The DCAA CAM and the applicable standard audit programs do not provide adequate guidance on performing an agreed-upon procedures engagement as an assist audit. CAM 14-1001(b) explains that under GAGAS, DCAA may perform an agreed-upon procedures engagement for any assignment if: (1) the subject matter or assertion to which the procedures are to be applied is subject to reasonably consistent measurement; (2) the requester and DCAA agree on the nature, timing and extent of the procedures to be applied, including the criteria to be used; and (3) the requester assumes responsibility for the sufficiency of the procedures. However, the DCAA guidance does not cover the additional steps required when an assist audit is requested or performed. Therefore, the DCAA guidance does not address the additional AICPA requirements in AT 201.15 and AT 601.18 that require [all] specified parties or users to agree to the procedures.

### ***Revised Finding and Recommendation***

We have added additional AICPA attestation standard references to the finding and Recommendation 16 to further clarify the requirements.

# **Recommendations, Management Comments, and Our Response**

## **Recommendations**

**We recommend that the Director, Defense Contract Audit Agency:**

- 16. Revise existing guidance on performing agreed-upon procedures engagements as assist audits to fully comply with the American Institute of Certified Public Accountants AT 201.15 and AT 601.18 requirements.**

## **DCAA Comments**

DCAA did not agree stating that the contracting officer was not a specified party to the assist agreed-upon procedures engagements reviewed by the DOD IG. DCAA also stated that the requesting audit office determined the procedures to be performed as part of its audit assignment and accepted responsibility for those procedures. Therefore, the contracting officer was not a specified party to the agreed-upon procedures and the audit office was not required to obtain the contracting officer's agreement on the procedures performed by the assist audit office.

## **Our Response**

DCAA comments were nonresponsive. We consider the contracting officer a specified party within the context of AT 201.03 and other referenced attestation standards included in the body of this finding. DCAA's main function is to perform contract audits for use by DoD procurement and contract administration offices. As such, another DoD component is generally the end user of DCAA reports. DCAA issued the reports under the reviewed assignments for contracting officer use during negotiations of contracts with contractors. We request that DCAA reconsider its position, and provide comments on the final report.

- 17. Provide training on performing generic agreed-upon procedures engagements to all DCAA auditors using training from an outside source such as the American Institute of Certified Public Accountants.**

## **DCAA Comments**

DCAA did not agree stating that providing agreed-upon procedures training to the audit staff would not be a responsible use of resources because the percentage of agreed-upon procedures assignments that DCAA performs is very low (approximately 1.3 percent in FY 2012).

## **Our Response**

DCAA comments were not responsive to the intent of the recommendation. DCAA assignments have consistently not complied with all attestation standards when performing agreed-upon procedures engagements. Any DCAA auditor could be assigned

this type of assignment. For performing attestation engagements, GAGAS requires auditors to be knowledgeable of the applicable AICPA standards and guidance and be competent in applying the standards and guidance to the task assigned. Therefore, all DCAA auditors need training on performing agreed-upon procedures engagements. This training can be part of a more comprehensive training class. DCAA should reconsider its position on this recommendation and provide comments on the final report.

## Performance Audit

Operations audits<sup>49</sup> are the only type of assignment that DCAA conducts as a performance audit<sup>50</sup> which is covered by GAGAS Chapters 6 and 7. The operations audit reviewed, Assignment Number 2241-2009B10501001, is 1 of the 37 assignments that demonstrated a lack of professional judgment. We based our determination on the deficiencies identified in multiple standards which included planning, communications, evidence, documentation, supervision, and reporting. The end result was an ineffective audit that took 9 months to complete and provided cost avoidance recommendations related to a contract task order that expired within weeks of report issuance. The waste of more than 1,100 audit hours, valued at about \$118,700, is of particular concern since the audit office in Afghanistan, which has limited resources to conduct high-risk, critical audits, performed the audit.

### ***Deficient Planning Negatively Impacted Completion of Assignment***

DCAA set up the operations audit we reviewed to evaluate the contractor's effectiveness in supporting operations under a logistics contract in Afghanistan. However, the audit office did not adequately plan the audit to address the objectives as required by GAGAS 7.06. We identified numerous deficiencies in the audit planning which resulted in a performance audit without a definitive audit objective or plan.

- The risk assessment did not comply with GAGAS 7.11a and 7.13 requirements. The risk assessment did not consider all the relevant contract and task order information nor did it adequately document a sufficient understanding of contract requirements necessary to plan the audit. The auditor did not consider the impact of contractor operations on the logistics contract in Afghanistan ending within the year. Neither did the auditor consider the relevancy of the processes selected for review to the contractor's other operations in Southwest Asia or to future task

---

<sup>49</sup> An operations audit is performed to inquire into contractor management and operational decisions that affect the nature and level of costs being proposed and charged to Government contracts. The auditor uses the knowledge gained from the audit as the basis for constructive recommendations to the contractor to improve its internal control structure and the economy and efficiency of its operations.

<sup>50</sup> GAGAS 1.25 defines performance audits as "...engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective actions, and contribute to public accountability."

orders on the follow-on logistics contract, if won. GAGAS requires auditors to assess audit risk and significance by obtaining an understanding of the nature of the program being audited and the potential use of the report.

- The auditor did not identify the sources of audit evidence, and the amount and type of evidence needed, given the audit risk and significance as required by GAGAS 7.12. The auditor listed general areas to probe in the risk assessment conclusion and did not identify the criteria and source documents to be used to perform the probe testing. This level of specificity was essential for the auditor to make a reasonable assessment from the probe testing on whether the contractor could achieve a significant cost avoidance in the reviewed area. Using this assessment the auditor would further determine whether a more detailed review of that area should be performed. In addition, the auditor did not perform any probe testing procedures for several of the areas listed in the risk assessment and did not document the basis for the decision not to perform any.
- The auditor did not adequately document the critical 'go or no go' decision. The related working paper did not explain the basis for the determination that certain areas were a 'go,' e.g. labor management, and certain were a 'no go,' e.g. build-up and draw down operations and subcontract processes. GAGAS 7.50 requires auditors to prepare a written plan that contains key decisions about the audit objectives, scope and methodology; and the auditor's basis for those decisions.
- The working papers did not have a detailed audit plan to review the labor management area determined to be a 'go' for evaluation. GAGAS 7.50 provides that the auditor should update the plan, as needed, to reflect any significant changes to the plan made during the audit. The decision to evaluate the labor management process required the auditor to formulate procedures to address the audit objectives for reviewing this process.
- The supervisory auditor did not properly supervise the audit planning as evidenced by the numerous deficiencies we identified. GAGAS 7.51 requires audit organization management to supervise audit planning and determine whether the audit plan adequately addresses relevant risks, the proposed scope and methodology are adequate to address the audit objectives, and available evidence is likely to be sufficient and appropriate for the purposes of the audit.

The numerous audit planning deficiencies led to a poorly executed audit.

### ***Inadequate Documentation and Insufficient Evidence***

The auditor did not adequately document the work performed in this audit and did not provide sufficient evidence to support the report conclusions and recommendations. A supporting working paper was missing and others were not referenced back to audit steps, causing the assignment to be difficult to follow. GAGAS 7.77 requires auditors to prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit documentation the nature, timing, extent, and results of procedures performed, the audit evidence obtained, and its source and the conclusions reached. The poor quality of audit documentation also contributed to deficiencies identified with the sufficiency of the evidence. The auditor did not provide sufficient evidence to support the revised recommended cost avoidance

amount. GAGAS 7.55 states that auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions. The original auditor identified seven findings on labor management and staffing in Afghanistan and calculated a cost avoidance of over \$32 million, which was included in the draft report. Several months later, another auditor determined that only one of the original conditions was valid based on the contractor's response to the draft report. The second auditor recalculated the cost avoidance of \$564,000 based on the expiring task order. However, the documented audit evidence does not support this audit conclusion. We were unable to determine from the inadequate and incomplete documentation what procedures were performed or additional evidence was obtained for the auditor to negate most of the original findings and significantly reduce the recommended cost avoidance amount.

### ***Ineffective Supervision***

Supervision of this audit was ineffective and failed to correct the significant deficiencies identified in audit planning, execution, and reporting. GAGAS 7.53 requires that audit supervisors properly supervise audit staff. The audit working papers contained some documented supervisory and management reviews of the audit; however, neither the supervisor nor audit manager signed off on the revised working papers, including the revised audit summary working paper that determined the original conditions and cost avoidance amount were not valid. GAGAS 7.80c provides that supervisory review of the work performed supporting findings, conclusions, and recommendations in the audit report should be documented prior to report issuance. The lack of documented supervisor or management review of these key working papers directly contributed to the deficiencies identified in the report as discussed in the next paragraph.

### ***Deficiencies in Reporting***

The final audit report contained several significant flaws. As previously discussed, the report was not timely or useful since the contractor's operations were ending in Afghanistan and the task order on which the cost avoidance was calculated was to expire shortly after the report issuance. The report also did not explain how the recommendations to improve the efficiency of the labor management process would positively impact the contractor's other operations in Southwest Asia. Additionally, the final report was confusing and difficult to understand. It listed all seven original findings from the draft report even though the audit office determined that only one finding should be reported after considering the contractor's response to the draft report. GAGAS 8.36 requires the auditor to modify the report when the auditor decides that the contractor's comments disagreeing with audit findings are valid. Therefore, the auditor should have included only the one finding in the final report. Also, while the contractor agreed with the one reported finding, the auditor did not obtain the contractor's position on the methodology used to calculate the cost avoidance. GAGAS emphasizes the importance of obtaining auditee comments to the development of a fair, complete, and objective report. GAGAS also permits the use of oral comments in certain circumstances. If the contractor disagrees with the recommended cost avoidance, the contracting officer's overall determination on the report recommendations is more difficult or time consuming without the auditor's rebuttal comments readily available. Finally, the audit office and regional technical specialists debated whether the report should be issued. The report, as



written, should not have been issued. It should either be supplemented to make it applicable to current or future contractor operations or rescinded as recommended in Recommendation 1 of this report.

## Appendix A. Scope and Methodology

We conducted this review from January 2010 through July 2012 in accordance with the Quality Standards for Inspection and Evaluation issued by the CIGIE.<sup>51</sup>

We accomplished our review of each report and its working papers using a standard checklist adapted from the checklist(s) in the CIGIE “Guide for Conducting External Peer Reviews of the Audit Organizations of Federal Offices of Inspector General,”

March 2009. We used the 2007 version of GAGAS issued by the Comptroller General of the United States, GAO-07-731G, to review the selected assignments. In performing our review, we assessed, reviewed, and evaluated:

- the independence documentation to verify compliance with GAGAS requirements and the measures that enable the identification of independence impairments;
- records of continuing professional education to verify compliance with GAGAS requirements; and
- 50 assignments and related project documentation to determine whether applicable standards and established policies and procedures were followed.

We selected the assignments to review using the DCAA Management Information System Analysis of the World reports for the first and second quarters of FY 2010. We determined how many of each type of engagements to review based on the number of those types of engagements DCAA completed in each quarter. In selecting the individual assignments to review, we obtained:

- a representative selection from all five regions and the Field Detachment; and
- a representative range of assignments performed by the subcategory. For instance, incurred cost audit engagements selected included engagements performed at both large and small contractors.

Table A briefly summarizes our assignment selection by region and Field Detachment and types of assignments.

---

<sup>51</sup> The Inspector General Reform Act of 2008, Public Law 110-409, created the CIGIE by combining what were formerly known as the President’s Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. The prior version of this publication was issued by the two predecessor organizations in January 2005 and was revised by CIGIE in January 2011.

**Table A. Assignments Selected for Review by Assignment Type and by Region and Field Detachment**

Type of Assignment	Total Number of Assignments Selected	DCAA REGION OR FIELD DETACHMENT					
		Central	Eastern	Northeastern	Mid-Atlantic	Western	Field Detachment
Forward Pricing <sup>52</sup>	21	4	3	4	3	5	2
Internal Control System Reviews <sup>53</sup>	7	2	2	1	1	1	0
Incurred Cost Audits <sup>54</sup>	12	3	1	2	2	2	2
All Other <sup>55</sup>	10	0	3	2	3	1	1
<b>Total Assignments Reviewed</b>	<b>50</b>	<b>9</b>	<b>9</b>	<b>9</b>	<b>9</b>	<b>9</b>	<b>5</b>

In addition, we reviewed all work referenced in the selected assignments including work performed in other assignments. Information on the deficiencies identified by individual assignments reviewed can be found in Appendix B, Summary of Review Findings by Assignment.

## Use of Computer-Processed Data

We did not rely on any computer-processed data as part of our review.

## Prior Coverage

During the last 5 years, the GAO and DOD IG have issued 12 reports related to similar issues with DCAA that are addressed in this report. The unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov/>, and unrestricted DOD Inspector General reports can be accessed at <http://www.dodig.mil>.

<sup>52</sup> Forward pricing assignments included forward pricing proposal audits, forward pricing rate agreement audits, pre-award accounting system reviews, parts of a proposal audits, and agreed-upon procedures attestation engagements.

<sup>53</sup> Internal Control Systems Reviews included a cross section of the various 10 internal control system reviews as explained in the 'Evidence' section of this report.

<sup>54</sup> Incurred Cost Audits deal with establishing final indirect rates and auditing the indirect and direct costs for the contractor's fiscal year.

<sup>55</sup> All Other assignments included a postaward audit, operations audit, termination, floor check, equitable adjustment, financial capability, two Cost Accounting Standards compliance reviews, and two special assignments.

## **GAO**

GAO Report No. GAO-12-88, "Actions Needed to Improve DCAA's Access to and Use of Defense Company Internal Audit Reports," December 2011

GAO Report No. GAO-09-468, "Widespread Problems with Audit Quality Require Significant Reform," September 2009

GAO Report No. GAO-08-857, "DCAA AUDITS: Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated," July 22, 2008

## **DOD IG**

DOD IG Report No. DODIG-2013-015, "Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency Functions," November 13, 2012

DOD IG Report No. DODIG-2012-038, "Hotline Complaint Concerning Inadequate Audit Services Provided by an Audit Team in the Defense Contract Audit Agency Mid-Atlantic Region," January 10, 2012

DOD IG Report No. D-2011-6-011, "Report on Hotline Allegation Regarding Lack of Agency Guidance on the Currency of Audit Testing in the Defense Contract Audit Agency," September 21, 2011

DOD IG Report No. D-2011-6-010, "Report on Failure of Defense Contract Audit Agency, Santa Ana Branch Office to Provide Adequate Support in Response to a Request for Review of Interim Public Vouchers," September 2, 2011

DOD IG Report No. D-2011-6-004, "Report on Quality Control Review of the Price Waterhouse Coopers, LLP and Defense Contract Audit Agency FY 2008 Single Audit of the Charles Stark Draper Laboratory, Incorporated," February 28, 2011

DOD IG Report No. D-2011-6-002, "Report on Quality Control Review of Deloitte & Touche, LLP and DCAA FY 2008 Single Audit of the Aerospace Corporation," October 29, 2010

DOD IG Report No. D-2009-6-009, "Audit Work Deficiencies and Abusive Work Environment Identified by the Government Accountability Office," August 31, 2009

DOD IG Report No. D-2007-6-006, "Review of the Defense Contract Audit Agency Quality Control System," May 1, 2007

DOD IG Report No. D-2007-6-005, "Congressional Inquiry Concerning Allegations at the Defense Contract Audit Agency Lockheed Martin Rockville Resident Office," April 25, 2007

## **Appendix B. Summary of Deficiencies Identified With Government Auditing Standards By Individual Assignment**

The schedule beginning on the next page summarizes our findings for each of the 50 assignments we reviewed. The schedule provides our assessment of whether the assignment complied with the GAGAS requirements for Professional Judgment, Independence, Competence, Quality Control, Planning, Evidence, Documentation, Supervision, and Reporting. Assignments in rows 1 through 47 in the schedule were performed as examination engagements; assignments in rows 48 and 49 were performed as agreed-upon procedures engagements; and the assignment listed in row 50 was performed as a performance audit. A “Yes” response in the column indicates that the assignment complied with the standard and a “No” response indicates that the assignment did not comply with the standard.

## Summary of Deficiencies with Government Auditing Standards Identified by Individual Assignment

ASSIGNMENT NUMBER	PROFESSIONAL JUDGMENT	INDEPENDENCE	COMPETENCE	QUALITY CONTROL	PLANNING	COMMUNICATION	EVIDENCE	DOCUMENTATION	SUPERVISION	REPORTING
<b>INCURRED COST</b>										
9851-2005F10100014	No	Yes	Yes	No	No	No	No	No	No	No
9731-2007B10100017	No	Yes	Yes	No	No	No	No	No	No	No
6161-2005A10100022	No	Yes	Yes	No	No	No	No	No	No	No
3541-2008K10100001	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes
3171-2006J10100002	No	Yes	Yes	No	No	No	No	No	No	No
2201-2006F10100003	No	Yes	Yes	No	No	No	No	No	No	No
4281-2005A10100006	No	Yes	Yes	No	No	No	No	Yes	No	No
1271-2007S10100011	Yes	Yes	Yes	No	Yes	No	Yes	Yes	Yes	Yes
2161-2006P10100005	No	Yes	Yes	No	No	No	No	No	No	No
4171-2006G10100007	No	Yes	Yes	No	No	No	No	No	No	No
3201-2007G10100023	Yes	Yes	Yes	Yes	Yes	No	Yes	No	Yes	Yes
6151-2007N10100001	No	Yes	Yes	No	Yes	No	No	No	No	No
<b>DEFECTIVE PRICING/POST AWARD REVIEW</b>										
6341-2008D42000026	No	Yes	Yes	No	No	No	No	No	No	No
<b>FLOOR CHECK</b>										
6211-2009C13500003	No	No	No	No	No	No	No	No	No	No
<b>TERMINATION</b>										
1241-2009H17100003	No	Yes	Yes	No	No	No	No	No	No	No
<b>EQUITABLE ADJUSTMENT</b>										
2901-2010A17200001	Yes	Yes	Yes	No	Yes	No	Yes	Yes	Yes	Yes
<b>FINANCIAL CAPABILITY</b>										
1621-2010C17600001	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes

"No" indicates assignment did not comply with the specific standard.

"Yes" indicates assignment complied with the specific standard.

If Professional Judgment indicates a "No" response, Supervision, Quality Control, and Reporting will also indicate "No" responses.

## Summary of Deficiencies with Government Auditing Standards Identified by Individual Assignment

ASSIGNMENT NUMBER	PROFESSIONAL JUDGMENT	INDEPENDENCE	COMPETENCE	QUALITY CONTROL	PLANNING	COMMUNICATION	EVIDENCE	DOCUMENTATION	SUPERVISION	REPORTING
SPECIAL AUDIT										
1661-2009H17900002	Yes	No	Yes	No	No	No	Yes	Yes	Yes	Yes
4901-2008W17900010	No	Yes	Yes	No	No	No	No	No	No	No
COST ACCOUNTING STANDARDS										
9811-2009A19100001	No	Yes	Yes	No	No	No	No	No	No	No
6141-2008M19418001	No	Yes	Yes	No	Yes	No	No	No	No	No
INTERNAL CONTROL SYSTEM REVIEWS										
2641-2009C11010001	No	Yes	Yes	No	No	No	No	No	No	No
4301-2009H11020002	No	Yes	Yes	No	No	No	No	No	No	No
3311-2008C11070001	No	No	Yes	No	No	No	No	No	No	No
6381-2009G11590001	Yes	Yes	Yes	No	No	No	No	Yes	No	Yes
1721-2009B14980001	No	No	Yes	No	Yes	No	No	No	No	No
1261-2010A12030001	No	Yes	Yes	No	No	No	No	No	No	No
3191-2009F13010001	No	Yes	Yes	No	No	No	No	No	No	No
FORWARD PRICING										
3531-2009L21000011	Yes	Yes	Yes	No	No	No	Yes	Yes	No	Yes
9861-2009P21000019	No	Yes	No	No	No	No	No	No	No	No
1461-2010D21000003	Yes	Yes	Yes	No	Yes	No	Yes	No	No	Yes
3121-2009H21000024	No	Yes	Yes	No	No	No	No	Yes	No	No
6321-2009U23000001	No	Yes	Yes	No	No	No	No	Yes	No	No
2651-2009H23000006	No	Yes	Yes	No	No	No	No	Yes	No	No
1301-2009B23000004	No	Yes	Yes	No	No	No	No	Yes	No	No
4181-2009A23000002	No	Yes	Yes	No	No	No	No	No	No	No

"No" indicates assignment did not comply with the specific standard.

"Yes" indicates assignment complied with the specific standard.

If Professional Judgment indicates a "No" response, Supervision, Quality Control, and Reporting will also indicate "No" responses.

## Summary of Deficiencies with Government Auditing Standards Identified by Individual Assignment

ASSIGNMENT NUMBER	PROFESSIONAL JUDGMENT	INDEPENDENCE	COMPETENCE	QUALITY CONTROL	PLANNING	COMMUNICATION	EVIDENCE	DOCUMENTATION	SUPERVISION	REPORTING
2501-2010H21000002	No	Yes	Yes	No	No	No	No	No	No	No
1251-2009F21000006	No	Yes	Yes	No	No	No	No	No	No	No
3561-2009D21000013	Yes	Yes	Yes	No	Yes	No	No	No	Yes	Yes
2801-2009G21000041	No	Yes	Yes	No	Yes	No	No	No	No	No
4721-2010L21000001	No	Yes	Yes	No	Yes	No	No	No	No	No
4261-2009T21000003	Yes	Yes	Yes	No	Yes	No	Yes	Yes	No	Yes
PARTS OF A PROPOSAL										
9761-2009T27000040	Yes	Yes	No	No	Yes	No	Yes	Yes	Yes	Yes
3521-2010V27000003	No	Yes	Yes	No	No	No	No	No	No	No
2211-2010N27000001	No	Yes	Yes	No	Yes	No	No	No	No	No
6701-2010S27000002	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes
ACCOUNTING SYSTEM REVIEW										
6431-2009B17740013	No	No	Yes	No	No	No	No	No	No	No
SUBTOTAL (NUMBER OF EXAMINATION ENGAGEMENTS WITH "NO" RESPONSES)	34	5	3	43	31	47	36	32	38	34
AGREED-UPON PROCEDURES										
4141-2009B28000001	No	Yes	No	No	No	No	No	Yes	No	No
4601-2010S28000001	No	Yes	No	No	No	No	No	No	No	No
PERFORMANCE AUDIT										
2241-2009B10501001	No	Yes	Yes	No	No	No	No	No	No	No
SUBTOTAL (NUMBER OF OTHER ENGAGEMENTS WITH "NO" RESPONSES)	3	0	2	3	3	3	3	2	3	3
GRAND TOTAL (NUMBER OF ALL ENGAGEMENTS WITH "NO" RESPONSES)	37	5	5	46	34	50	39	34	41	37

"No" indicates assignment did not comply with the specific standard.

"Yes" indicates assignment complied with the specific standard.

If Professional Judgment indicates a "No" response, Supervision, Quality Control, and Reporting will also indicate "No" responses.



---

# Defense Contract Audit Agency Comments



DEFENSE CONTRACT AUDIT AGENCY  
DEPARTMENT OF DEFENSE  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219

September 17, 2012

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT  
POLICY AND OVERSIGHT, OFFICE OF THE INSPECTOR  
GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Response to Office of Inspector General, Department of Defense, Draft Report,  
Monitoring of the Quality of the Defense Contract Audit Agency Audits (Project No.  
D2010-DIP0AC-0115.000)

Thank you for the opportunity to respond to the subject draft report provided to DCAA on August 2, 2012. The issues discussed in the report are important. However, the utility of the report is very limited because the findings are based on old data and do not reflect the current state of the Agency.

The majority of the audit work reviewed by DoDIG occurred between 2006 and 2009—more than three years ago. As a result, the findings are similar to those in a Government Accountability Office (GAO) report issued in September 2009. We took decisive actions and made major changes to correct the problems GAO identified. However, the DoDIG report focuses on work done prior to or immediately following the issuance of the GAO report, and, therefore, does not recognize the significant progress we have made during the past three years.

DCAA actions to improve audit quality and training include the following:

#### *Audit Quality*

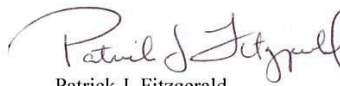
- Integrity and Quality Assurance Directorate: We established this office in FY 2009 to conduct Agency-wide comprehensive quality assurance reviews that measure our overall audit quality and guide the development of our auditor training. The head of this office reports directly to the Director of DCAA to ensure that quality issues receive top-level attention.
- Field Audit Office (FAO) Assistant for Quality: In FY 2010 we established this position at FAOs to provide field level support to help ensure that audits are of the highest quality and in accordance with professional standards.
- Revised audit programs: We issued new and significantly revised audit programs based on recent, relevant audit challenges, resulting in more accurate and consistent application of audit procedures.

- Independent referencing: In July 2011 we issued guidance that required that an experienced auditor (such as a supervisor or technical specialist) who did not work on the assignment being reviewed would conduct an independent reference review of the audit report to ensure that the information in the report is fully supported by sufficient appropriate evidence in the working papers.
- Enhanced statistical sampling: We made our sampling guidance more rigorous in June 2010 so that our sample results would have a 90-percent confidence level.

#### *Training*

- Agency-wide Quality Training: We developed this intensive, three-day training program as the foundation of our efforts to improve audit quality after the GAO report. We conducted this training at each of our 112 Field Audit Office locations during December 2010 to April 2011 to ensure that all auditors had a better understanding of quality expectations.
- Training After Quality Assurance Reviews: We began giving this on-site training in June 2011 and we have continued to give it to local auditors at the conclusion of each quality assurance review to focus on the specific problems found during the review to ensure that any needed corrective action is fully understood and taken promptly.
- Supervisory Auditor Assignment Review Process Workshop: We developed this course as a result of our internal quality assurance reviews, and it is being given to all supervisory auditors to explain their roles and responsibilities in the audit process. This training began in May 2012 and is scheduled to be completed in January 2013.
- Agency-wide GAGAS Training: This detailed 11-hour online course on Generally Accepted Government Auditing Standards was taken by all auditors in FY 2010 and by all subsequently hired auditors.

As a result of these and other actions, we have made—and are continuing to make—major progress in increasing our audit quality. We concur in principle with many of the recommendations in this DoDIG report; as we have indicated, we had already begun or completed similar corrective actions in response to the earlier GAO report. Our specific responses to your recommendations are attached.

  
Patrick J. Fitzgerald  
Director

Attachment:  
As stated

---

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

**DoDIG Recommendation 1:** We recommend that the Director, Defense Contract Audit Agency: Direct each audit office to take the headquarters-determined corrective action(s) for assignments listed in Appendix B as not demonstrating professional judgment. Corrective actions should include:

- a. Rescinding the reports and notifying those who received the reports not to rely on them, or performing additional work and supplementing the original report, whichever action is most appropriate depending on how contracting officers are using or relying on the report or information in the report.
- b. Inserting into the engagement or audit documentation file a memorandum stating that the engagement or audit did not comply with government auditing standards, the work should not be relied on for other engagements or audits, and the assignment should not be used as an example to perform other engagements or audits.
- c. Reviewing the deficiencies identified in the various assignments and taking appropriate corrective actions regarding the audit staff involved to include additional training when warranted.

**DCAA Response:**

Recommendation 1a: Concur in principle.

Because the audit reports in question were issued a number of years ago, many of their related actions likely have been completed and/or the reports are irrelevant due to subsequent events or the passage of time. Nevertheless, DCAA is committed to taking the actions necessary to adhere to auditing standards and protect the Government's interest. DCAA will assess the circumstances for the reports DoDIG notes as not demonstrating professional judgment (Appendix B) and determine the appropriate actions in each circumstance. In order to perform this assessment without unnecessarily duplicating work already performed by the DoDIG, we need additional information from the DoDIG on the noncompliances with Generally Accepted Government Auditing Standards (GAGAS) and the specifics leading to those conclusions. We expect to complete these actions by June 30, 2013.

Recommendation 1b: Concur.

For assignments DoDIG notes as not demonstrating professional judgment (Appendix B), we will include a memorandum in the applicable audit documentation file stating that the engagement did not comply with government auditing standards and that the work should not be relied on or used as an example for other engagements. We expect to complete these actions by December 31, 2012.

Recommendation 1c: Concur in principle.

The action to address the intent of the recommendation is complete. As discussed in our response to Recommendation 2 below, since FY 2009, DCAA has taken, and continues to take, significant steps to improve audit quality and limit similar shortcomings in future audits. These steps include extensive training of all DCAA audit staff, which includes the staff involved in

---

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

those assignments DoDIG identified as not demonstrating professional judgment.

**DoDIG Recommendation 2:** Re-emphasize the importance of compliance with government auditing standards and applicable Defense Contract Audit Agency policies and procedures through issuance of alerts or other appropriate memorandums detailing the various deficiencies identified, causes, and corrective actions to be taken by all audit offices.

**DCAA Response:** Concur in principle.

The action to address this recommendation is complete. Since FY 2009, DCAA has taken, and continues to take, significant steps to improve audit quality such as providing extensive training and issuing a significant number of audit guidance memorandums. Although it will take time to realize the full effect of the completed and continuing corrective actions, we have already seen tangible results. For example, in recent quality assurance reviews, the results for a number of field audit offices show that all audits met the overarching GAGAS general standard related to professional judgment. We believe that the following portfolio of efforts—both completed and in process—satisfies the intent of your recommendation.

Training to support compliance with GAGAS

*Training Initiative on Performing Quality Audits.* Three-day comprehensive training sessions were delivered Agency-wide at 112 field audit offices between December 2010 and April 2011. The training sessions focused on performing quality audits and were comprised of the following key elements: (1) understanding the request for audit, the basis of the contractor's assertion and planning the appropriate audit; (2) conducting and documenting efficient and effective audits; (3) developing and reporting sound audit conclusions; and (4) reviewing the results of internal quality assurance reviews related to various noncompliances with GAGAS and/or Agency policy and procedures, their root causes, and corrective actions.

*GAGAS Training* (on-line course 1440). An 11-hour continuing professional education (CPE) course was developed by the Defense Contract Audit Institute and first offered in April 2010. All auditors are required to take this course that emphasizes the level of assurance for the various types of engagements and provides guidance on auditor independence, planning, fraud risk, level of testing, supervision, auditor judgment, audit documentation and reporting.

*Field Audit Office (FAO) Assistant for Quality.* This position, created in July 2010, is located in field audit offices. The individual supports the FAO Manager by assisting with a variety of audit-related assignments, audit processes, and/or audit interim and pre-issuance reviews of FAO audits and audit reports. This support involves a review of audit work to ensure compliance with GAGAS. A three-day training session was developed in FY 2012 and is being delivered to the FAO Assistants for Quality in each region. The training covers: (1) updates to audit policy guidance, risk assessment requirements, and statistical sample requirements; (2) guidance on pre-issuance and interim reviews of audits; and (3) discussion of key findings from internal quality assurance reviews. The training has been institutionalized, will be updated for current issues, and provided semi-annually.



DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

*Integrity and Quality Assurance Directorate Webpage.* The webpage provides auditors real-time results of internal quality assurance reviews, specific examples of noncompliances with government auditing standards and/or applicable Defense Contract Audit Agency policies and procedures. The webpage also includes recommendations to avoid similar noncompliances in the future.

*Supervisory Auditor Assignment Review Process Workshop.* This training is being delivered to all Supervisory Auditors, Agency-wide, from May 2012 through January 2013. The supervisor has the fundamental responsibility of ensuring that each assignment is conducted in accordance with GAGAS. The training focuses on the role of the supervisor in an engagement during initial planning phase, risk assessment phase, interim review phase, and final supervisory review phase. Arrangements have been made for the DoDIG to observe five of the workshops.

*FAO Manager's Conferences.* These conferences were held in December 2010 and November 2011, and another is planned for November 2012. At the 2011 conference, the Undersecretary of Defense, Comptroller, discussed the importance of performing quality audits that protect the public interest. At each conference, the DCAA Assistant Director of Integrity and Quality Assurance presented the results of recent quality assurance reviews. His presentation focused on ensuring GAGAS compliance, including pertinent issues, root causes of problems, and specific recommendations.

Memorandums to the workforce

DCAA's audit guidance memorandums are both emailed to the workforce and posted on the DCAA intranet. The following is a list of key memorandums DCAA issued to increase our effectiveness in terms of audit quality. DCAA will keep the DoDIG apprised of additional memorandums as they are disseminated.

Date	Memorandum for Regional Director (MRD) No.	Subject
October 9, 2009	09-PAS-019(R)	Mandatory Training – CMTL 1269 Working Paper Documentation
October 22, 2009	Q 720.7.A	Recurring Issues Commonly Found in Quality Assurance Reviews
April 14, 2010	Q 720.7.A	Recurring Issues Commonly Found in Quality Assurance Reviews
September 16, 2010	10-PAS-025(R)	FY 2010 Annual Training on the Generally Accepted Government Auditing Standards (GAGAS) Independence Standards
October 20, 2010	10-OTS-069(R)	Guidance on Attribute Sampling Policy

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

December 15, 2010	10-PAS-035(R)	Audit Guidance on Contractor Notification Letters
January 3, 2011	11-OTS-011(R)	Guidance on Variable Sampling Policy
July 7, 2011	11-PAS-010(R)	Audit Alert on Timely Resolution of Independence Impairments
July 26, 2011	11-PPS-012(R)	Audit Guidance on Independent Reference Reviews
December 14, 2011	11-PAC-021(R)	Audit Alert on Performance of Audit Steps to Test Cost Accounting Practices for Compliance with Cost Accounting Standards in Current Audits
April 24, 2012	12-PAS-012(R)	Audit Guidance on Auditing Contractor Business Systems and Contractor Compliance with DFARS 252.242-7006, Accounting System Administration
May 2, 2012	12-PAS-015(R)	Audit Guidance on Performing Sufficient Testing
July 25, 2012	12-PPS-018(R)	Audit Guidance – Denial of Access to Records Due to Contractor Assertion of Attorney-Work-Product Doctrine or Attorney-Client Privilege

**DoDIG Recommendation 3:** Emphasize to the audit staff the importance of reporting and elevating all access to records issues following the established DCAA process and procedures.

**DCAA Response:** Concur in principle.

The action to address this recommendation is complete. The *Training Initiative on Performing Quality Audits* (discussed in our response to Recommendation 2) included a presentation on access to records issues. The training material emphasized the importance of following the established DCAA process and procedures, including elevating all access to records issues. In addition, DCAA's annual independence training (online course 9022, updated annually) was revised in September, 2010, to emphasize the importance of following procedures and elevating access to records issues. Finally, on July 25, 2012, DCAA issued additional guidance (MRD 12-PPS-018) to address access to records issues involving the assertion of attorney-client privilege or attorney-work-product doctrine.

**DoDIG Recommendation 4:** Revise existing guidance on handling access to records issues to instruct audit offices to consider whether a contractor's policies or procedures could not only impede the audit office's own engagement or audit but another audit office's engagement or audit.

Deleted

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

**DCAA Response:** Nonconcur.

The circumstances that appear to have prompted this recommendation are described on page 10 of the DoDIG draft report. Those circumstances involved DCAA access to information that the contractor considered to be particularly sensitive. Based on our review of FAO correspondence related to this issue, the FAO vigorously pursued access to the information. Arrangements were made that addressed the contractor's concerns while, at the same time, enabled DCAA access to the information necessary to meet the audit objectives. The FAO informed the DoDIG that the arrangement did not negatively impact its review. The DoDIG notes that during a discussion with the FAO, a contractor representative stated that the contractor **wanted** to restrict all DCAA access to the document in question; however, there was no indication that the restriction was imposed. Nonetheless, based on these circumstances, the DoDIG concluded that by not formally notifying the contractor that the arrangement only applied to the particular engagement, the FAO caused a **potential** access issue, as well as an independence impairment in general. As a result of their conclusions, they recommended that DCAA revise its guidance to address such circumstances.

We disagree with the DoDIG's conclusion and recommendation. GAGAS requires auditors to be independent in all matters related to the audit work (GAGAS 3.02). There was no impairment for this audit because the FAO was able to make reasonable arrangements for access to information sufficient to meet the audit objectives. One cannot assume that there will be an impairment to independence for future audits simply based on a verbal statement made by a contractor representative that the contractor **wanted** to restrict all DCAA access to a particular document. Such a statement is not a policy to deny or an actual denial of access. Any future issues related to access to records would be appropriately covered by DCAA's policy on denial of access to records.

We believe that our access to records guidance (including DCAA Instruction 7640.17) is comprehensive and sufficient to address contractor denial of access to records issues without being overly prescriptive. Circumstances related to access to contractor records vary significantly, and FAOs need to have flexibility to exercise professional judgment on a case-by-case basis. Our guidance already requires FAOs to notify contractors in writing if the FAO believes contractor policies and procedures will invoke unreasonable delays, waste audit time, or otherwise impede the orderly progress of the audit. We see no benefit in establishing a policy that would require formal notification to contractors regarding "potential access issues" based on verbal comment made by a contractor representative.

**DoDIG Recommendation 5:** Improve the effectiveness of Defense Contract Audit Agency training by:

- a. Performing a comprehensive review and analysis of the Defense Contract Audit Agency continuing professional education training program, including course curriculum, content and delivery methods, to identify appropriate areas for enhancement of the individual and collective competency of its staff.



DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

- b. Using outside sources for certain core training courses to supplement existing Defense Contract Audit Agency training courses in various areas, including but not limited to, government auditing standards, internal controls and related systems reviews, and American Institute of Certified Public Accountants attestation standards.
- c. Performing an analysis for the implementation of a robust on-the-job coaching program to provide auditors and supervisors more hands-on training regarding proper application and interpretation of government auditing standards and related American Institute of Certified Public Accountants attestation standards.

Renumbered  
as  
Recommend  
ation 4b

Renumbered  
as  
Recommend  
ation 4c

**DCAA Response:**

Recommendation 5a: Concur in Principle.

DCAA continually strives to deliver effective training. For example, DCAA has integrated training on government auditing standards and related American Institute of Certified Public Accountants (AICPA) attestation standards into several training courses and workshops for auditors, supervisors, and/or FAO assistants for quality. These are described in the response to Recommendations 2 and 5.b. DCAI has also reviewed all courses to ensure that GAGAS requirements are fully addressed when pertinent to the subject matter. In addition, the DCAA Advisory Council on Learning and Talent Development has undertaken a project to review the DCAI curriculum, delivery methods, and locations. Initial results are expected by September 30, 2012. The timeframe for implementation of Council recommendations will be established once they are known.

Recommendation 5b: Concur in Principle.

The action to address this recommendation is complete. DCAA already makes use of external training. A representative from the AICPA provided eight hours of training on the requirements of GAGAS at the May 2012 Quality Workshop, and a Government Accountability Office GAGAS expert will give training on the 2011 revision to the Yellow Book; this training will be videotaped and distributed Agency-wide. We continue to look for opportunities to use external sources for training. However, based on our recent experience, most externally prepared training needs to be significantly tailored for our contract audit environment to be effective for our audit staff. We have found that an effective alternative is to use external training sources as a resource when developing DCAA-specific training. For example, to assist DCAI in developing course content that reflects GAGAS, headquarters staff members have used concepts from external training materials, tailored for DCAA's contract audit environment.

Recommendation 5c: Concur in Principle.

The action to address this recommendation is complete. DCAA has already established a coaching program that is currently in the pilot stage. The intent of the program is to improve the technical skills and performance of the less experienced employee. We believe that the coaching program, along with the structured training described in responses to Recommendations 2 and 5.b, addresses the intended objective of this recommendation.



DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

**DoDIG Recommendation 6:** Revise guidance on maintaining Statements of Independence to specify that all written explanations describing exceptions to personal independence provided to the first level supervisor must also be maintained for the same period of time as the Statements.

**DCAA Response:** Concur in principle.

We believe that the new policy in development will address the intended objective of your recommendation. We are in the process of revising Agency policy to provide for assignment specific Statements of Independence. Under the new policy, the Statements of Independence will apply only to the particular assignment and the applicable contractor and will not include a reference to independence issues related to other contractors. Therefore, it would not be appropriate to attach a recusal letter related to such issues. Further, given the revised policy, reviewers should not need to see recusal letters related to other contractors to establish that the auditor was independent for that assignment. We expect to issue the revised guidance by June 30, 2013.

**DoDIG Recommendation 7:** Perform an assessment of the new hire on-boarding process and implement the additional steps or controls needed to ensure that newly hired auditors complete independence training and submit a Statement of Independence within the first week of work at the audit office or prior to working on any assignment, whichever event occurs first.

**DCAA Response:** Concur in Principle.

The action to address this recommendation is complete. DCAA has already performed an assessment of the new hire on-boarding process and is implementing a consistent approach for bringing entry level auditors into the Agency from the day they accept the job offer through their first year on the job. The on-boarding process includes a variety of GAGAS-related training including training on the GAGAS Independence Standards (on-line course 9022), as well as a requirement for the supervisor to explain auditor independence and ensure that the Statement of Independence is signed prior to beginning any audit work.

**DoDIG Recommendation 8:** Issue guidance directing regions, Field Detachment, and audit offices to fully comply with Generally Accepted Government Auditing Standards paragraph 3.52 requirements to maintain documentation of all quality control procedures performed by the regions, Field Detachment, or audit offices such as participatory team member reviews or regional audit manager pre-release reviews, for a sufficient amount of time so that reviewers can evaluate the extent of their compliance with the relevant quality control procedure.

**DCAA Response:** Concur in principle.

We believe that the implementation of the DCAA independent reference review policy, together with any additional actions we may determine are appropriate as a result of our in-process

Renumbered  
as  
Recommend  
ation 5

Renumbered  
as  
Recommend  
ation 6

Renumbered  
as  
Recommend  
ation 7

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

Pages 22-25

publication system reform initiative, will address the intended objective of this recommendation. Based on the discussion on pages 19 through 21 of the DoDIG draft report, this recommendation appears to have been prompted because pre-issuance reviews by regional audit managers, regional technical specialists, and/or participatory work team (PWT) members were not performed for many of the 50 assignments the DoDIG reviewed, and that documentation was not available for 4 of the 24 assignments that required PWT reviews. As noted in the DoDIG draft report, DCAA implemented independent reference reviews in July, 2011, as a component of the Agency's commitment to provide quality audit reports in compliance with applicable auditing standards. As a result, the independent reference review is DCAA's primary quality control pre-issuance review. The policy regarding those reviews is documented in DCAA Instruction 7642.1, Independent Reference Review Policies and Procedures. The checklists for those reviews are delivered automatically by DCAA's Audit Planning & Performance System to all assignments requiring an independent reference review, and the results of those reviews are maintained in the assignment files. These new procedures should ensure that the documentation of these reviews is maintained in accordance with the GAGAS 3.52 requirement. It should also be noted that PWT reviews were primarily intended for audit team developmental purposes and have never been considered a part of DCAA's formal quality control system.

Regarding pre-issuance reviews that may be a part of regional or FAO-specific procedures, DCAA has already undertaken a publication system reform initiative, which includes a review of regional and Field Detachment quality control publications. One of the objectives of the initiative is to ensure consistency across the Agency by eliminating regional and Field Detachment publications that cover areas that are, or should be, addressed by Agency-wide publications. This reform initiative will include an assessment of any regional and Field Detachment pre-issuance review requirements and other quality control requirements to determine if they should be eliminated or adopted Agency-wide in light of the Agency's independent reference review requirements. We expect to complete our assessment by March 31, 2013.

**DoDIG Recommendation 9:** Review existing audit office, regional and Field Detachment quality control procedures to identify best practices or other possible quality procedures to be implemented that would be effective in ensuring audit quality and compliance with government auditing standards. The review should consider establishing minimum standards for regional and Field Detachment quality control procedures, as well as audit office quality control procedures, to better ensure effective implementation of the DCAA quality control system.

**DCAA Response:** Concur in principle.

During the course of an internal quality assurance review, the quality assurance auditor has the opportunity to identify audit practices and processes that lead to and maintain audit quality. We already communicate these best practices to other auditors through training, presentations at staff conferences, the Quality website, and suggestions for improvement in our quality assurance reports. In addition, as discussed in our response to Recommendation 8, DCAA has already undertaken a publication system reform initiative, which includes an assessment of any regional

Renumbered  
as  
Recommend  
ation 8

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

and Field Detachment pre-issuance review requirements and other quality control requirements to determine if they should be eliminated or adopted Agency-wide. We expect to complete that assessment by March 31, 2013.

**DoDIG Recommendation 10:** Review the electronic standard working paper software and documents in the "Audit Planning & Performance System" to determine appropriate revisions to prompt auditor compliance with government auditing standards and Defense Contract Audit Agency policies and procedures such as:

- a. Require the listing of specific criteria in the source section of each working paper;
- b. Revise all standard risk assessment working papers to require the auditor to list the factors used to determine the materiality and sensitivity of the assignment; and
- c. Add a procedure to the concluding steps to remind the auditor that additional procedures need to be considered and performed when internal control deficiencies or potential fraud, illegal acts, abuse or violations of contract provisions are identified.

**DCAA Response:**

Recommendation 10a: Concur.

We will make appropriate revisions to our Audit Planning & Performance System to require working papers to identify, if applicable, the specific criteria used in the evaluation covered by the working paper. We expect to have this action completed by December 31, 2012.

Recommendation 10b: Concur in principle.

The action to address this recommendation is complete. DCAA's current risk assessment working papers (working paper B) for all applicable assignments already require auditors to document significant materiality and sensitivity factors. For example, in a proposal audit, such factors would include contract type, proposal dollar value, basis of proposal, needs of the requestor, use of subcontractors, special Request for Proposal/Request for Quotation provisions, etc. Auditors are required to determine the effect of those factors on the proposal being audited; additionally, the impact of those factors is also considered in the review of individual cost elements.

Recommendation 10c: Concur in principle.

The action to address this recommendation is complete. It is not clear from the information provided in the report what DoDIG findings prompted this recommendation. However, the recommendation appears to be related to the GAGAS 6.33 requirement that for attestation engagements, auditors should report, as applicable to the objectives of the engagement and based on the work performed, internal control deficiencies, fraud, illegal acts, abuse and violations of contract provisions. The primary objective of most DCAA audits is to evaluate the contractor's compliance with applicable laws, regulations, and contract terms. Therefore, audit procedures to test for such compliance are included throughout the audits. In addition, DCAA has recently



DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

completed a project (which was started in July 2011) to revise all applicable audit programs to include, as a part of the risk assessment procedures, planning meetings with the audit team to discuss the risk of fraud and other noncompliances with applicable laws and regulations that could have a material effect on the audit, and to design audit procedures to address the identified risk. Furthermore, DCAA has had a long standing policy to report potential internal control deficiencies identified during other related audits. The comprehensive business system guidance issued on April 24, 2012 (MRD 12-PAS-012), revised and enhanced our policies and procedures for reporting business system deficiencies identified in other than business system audits.

**DoDIG Recommendation 11:** Revise the guidance and examples of Acknowledgement and Notification Letters to comply with generally accepted government auditing standard paragraph 6.07 on auditor communication during planning.

**DCAA Response:** Concur.

We revised DCAA's acknowledgement and notification letters to state that an examination-level attestation engagement will be performed and explain what the attestation engagement consists of (based on the definition of examination at GAGAS 1.23a). We completed this action on September 10, 2012.

**DoDIG Recommendation 12:** Increase the effectiveness of and compliance with fraud-related standards by:

- a. Developing a toolkit for auditors to use when assessing fraud risk indicators to determine which procedures or steps to include to cover each fraud indicator identified during planning. It should also provide information on determining which steps to expand, alternative steps to perform when more appropriate than expanding existing steps, and include addressing any fraud indicator found during the execution phase of the engagement;
- b. Revising guidance to include a revised fraud risk assessment procedure in which the audit team (managers, supervisors, and auditors) discusses the risk of fraud for that engagement and design procedures to address the identified fraud risks as required by government auditing standards; and
- c. Revising guidance and all applicable standard audit programs to require the audit staff to ask pertinent questions of appropriate level contractor personnel regarding the contractor's assessment of fraud risks relating to the assertion or subject matter of the engagement.
- d. Assess the August 2011 version of the Fraud Awareness training course to determine whether it covers all DCAA required processes associated with identification, detection, and reporting of potential fraud and revise the course, as needed, to provide such coverage.

Renumbered  
as  
Recommend  
ation 10

Revised and  
renumbered  
as  
Recommend  
ation 11a

Renumbered  
as  
Recommend  
ation 11b

Renumbered  
as  
Recommend  
ation 11c

Renumbered  
as  
Recommend  
ation 11d

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

**DCAA Response:**

Recommendation 12a: Concur in principle.

We believe that actions already completed, together with any additional enhancements as a result of our assessment currently in process, will address the intended objective of this recommendation. DCAA has recently completed a project (which was started in July 2011) to revise all applicable audit programs to include, as a part of the risk assessment procedures, planning meetings with the audit team to discuss the risk of fraud and other noncompliances with applicable laws and regulations that could have a material effect on the audit. Based on those discussions and other risk assessment procedures, the audit team designs audit procedures that are appropriate in the particular circumstances. DCAA also has a project in place to assess the need for further enhancement of audit procedures related to the risk of fraud. However, we disagree with the DoDIG's specific recommendation to provide a "toolkit" of steps for each fraud indicator because that approach could lead to a "checklist mentality." We believe that our current teaming approach—one that allows for developing procedures based on specific circumstances—encourages critical thinking and is therefore a better solution. We expect to complete our assessment by June 30, 2013.

Recommendation 12b: Concur in principle.

The action to address this recommendation is complete. Effort was started in July 2011 to update standard audit programs to include a requirement for the audit team to discuss the risk of fraud and design procedures to address the identified risks. As of June 2012, DCAA has revised all applicable audit programs to include, as a part of the risk assessment procedures, planning meetings with the audit team to discuss the risk of fraud and other noncompliances with applicable laws and regulations that could have a material effect on the audit. Based on these discussions and the other risk assessment procedures, the audit team designs audit procedures to address the identified fraud risks.

Recommendation 12c: Concur in principle.

We believe that the actions already completed (as discussed in our response to Recommendation 12a) together with any additional enhancements we make as a result of our ongoing project, will address the intended objective of this recommendation. The draft report states on page 43 that the 2011 GAGAS indirectly incorporates Statements on Auditing Standards (SAS) 99, which require audit staff to inquire of company management about its assessment of fraud risk. GAGAS on attestation engagements incorporates the AICPA's Statements on Standards for Attestation Engagements (SSAE) by reference. Paragraph AT 601.33 of the SSAE requires auditors to consider factors affecting risk similar to those discussed in AU Section 316, Consideration of Fraud in a Financial Statement Audit, paragraph .85 (Appendix to SAS 99). It does not incorporate all of SAS 99 and the requirement to inquire of company management about its assessment of fraud risk is not one of the factors listed in paragraph .85. Nevertheless, DCAA has a project in place to assess whether enhancements are needed to supplement guidance related to the risk of fraud beyond those already made. Consistent with GAGAS 6.13 (Footnote 81), which notes that SAS 99 may provide useful guidance related to fraud for attestation engagements, we are considering all of the SAS 99

Revised  
Finding  
Page 48

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

requirements as part of that project. We expect to complete our assessment by June 30, 2013.

Recommendation 12d: Concur.

DCAA will assess the August 2011 version of the Fraud Awareness training course and revise the course, as needed, for changes to guidance made in response to Recommendations 12.b and 12.c above. We expect to complete this action by December 31, 2013.

**DoDIG Recommendation 13:** Improve the effectiveness of supervisory auditors and compliance with government auditing standards by:

- a. Revising existing standard electronic working papers that supervisory auditors use to document supervisory guidance and review to address specific government auditing standards and Defense Contract Audit Agency guidance requirements;
- b. Providing additional tools such as a link to suggested potential corrective actions to remedy any identified deficiencies, and reminder checklists directly linked to the electronic working paper packages for supervisory auditors to use as aids when reviewing assignments; and
- c. Moving the audit guidance on performing and documenting supervisory reviews from the Defense Contract Audit Agency Contract Audit Manual to a location or source directly linked to the electronic working paper packages so that the information is more readily available to users.

**DCAA Response:** Concur in principle.

DCAA concurs in principle with Recommendations 13a, 13b, and 13c, and the action to address the intent of these recommendations is complete. We have already taken, and continue to take, steps to improve the effectiveness of supervisory auditors in complying with government auditing standards. However, we disagree with the DoDIG's specific recommendations for achieving this objective. We believe that the approach reflected in these recommendations (e.g., providing suggested potential corrective actions and reminder checklists) could lead to a "checklist mentality" rather than the critical thinking skills that we want our supervisors to use in determining the appropriate corrective actions for each specific circumstance. We believe that improving the effectiveness of supervisory audits is best addressed with training and other initiatives that encourage these critical thinking skills and help supervisors understand their responsibilities under the standards and DCAA policy. In FY 2011, DCAA required all supervisory auditors to attend an updated supervisory training course that addressed a range of supervisory auditor responsibilities, including both personnel and audit management. In addition, our Integrity and Quality Assurance Directorate is providing training on reviewing working papers at the *Supervisory Auditor Assignment Review Process Workshop*, discussed in our response to Recommendation 2. Another initiative that DCAA has undertaken to assist supervisory auditors is the coaching program discussed in our response to Recommendation 5c. We believe that these efforts address the intended objective of your recommendations.

Renumbered  
as  
Recommend  
ation 12



DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

**DoDIG Recommendation 14:** Revise existing guidance on reporting scope limitations or qualifications to comply with generally accepted government auditing standards paragraph 1.12b and American Institute of Certified Public Accountants AT 107.74 requirements.

**DCAA Response:** Concur in principle.

The action to address the intent of this recommendation is complete. The specific instances cited in the draft DoDIG report do not indicate exceptions to the guidance, but instead appear to be implementation issues. The *Training Initiative on Performing Quality Audits* discussed in our response to Recommendation 2 included a discussion of scope limitations and the need to appropriately qualify reports.

**DoDIG Recommendation 15:** Revise existing training to emphasize to the audit staff the importance of including the effect of any access to records issue on the engagement in the applicable report.

**DCAA Response:** Concur in principle.

The action to address this recommendation is complete. The *Training Initiative on Performing Quality Audits* discussed in our response to Recommendation 2 included a discussion of scope limitations and the need to appropriately qualify reports. Also, DCAI Course 6115, Effective Report Writing, contains a section on Lack of Access to Contractor Records, which includes a handout of DCAA Instruction 7640.17, Formal Reporting Procedures for Denial of Access to Contractor's Records. This course is required for all auditors during their second year with DCAA.

**DoDIG Recommendation 16:** Issue a memorandum to the audit staff re-emphasizing the importance of including the effect of any access to records issue on the engagement in the applicable report.

**DCAA Response:** Concur in principle.

The action to address the intent of this recommendation is complete. The *Training Initiative on Performing Quality Audits* discussed in our response to Recommendation 2 included a discussion of scope limitations, including denial of access to records and the need to appropriately qualify reports. This training was provided to all audit staff between December 2010 and April 2011.

**DoDIG Recommendation 17:** Revise existing guidance on performing agreed-upon procedures engagements as assist audits to fully comply with the American Institute of Certified Public Accountants AT 201.15 requirements.

**DCAA Response:** Nonconcur.

Renumbered  
as  
Recommend  
ation 13

Renumbered  
as  
Recommend  
ation 14

Renumbered  
as  
Recommend  
ation 15

Renumbered  
as  
Recommend  
ation 16

DCAA Responses to DoDIG Recommendations (Project No. D2010-DIP0AC-0115.000)

This recommendation appears to be based on the DoDIG's conclusion that the original requestor was a specified party to the agreed-upon procedures for the two agreed-upon procedures assignments reviewed and that, as a result, DCAA was required by the auditing standards to obtain the original requestors' agreement with the procedures performed by the assisting FAOs. We disagree. In both assignments, the requesting FAO was performing an examination for the contracting officer (the original requestor). The requesting FAO needed certain procedures to be performed as part of the examination and engaged the assist FAO to perform the procedures as an agreed-upon procedures engagement. Based on the risk assessment, the requesting FAO determined the specific procedures needed and accepted responsibility for those procedures. The final product to the original requestor was an examination report. Therefore, the original requestor was not a specified party to the agreed-upon procedures and there was no requirement for DCAA to obtain the original requestor's agreement.

**DoDIG Recommendation 18:** Provide training on performing generic agreed-upon procedures engagements to all DCAA auditors using training from an outside source such as the American Institute of Certified Public Accountants.

**DCAA Response:** Nonconcur.

We do not concur with the recommendation to provide training on agreed-upon procedures to all auditors. The number of assignments performed as agreed-upon procedures is very low, representing only 1.3 percent of the reports issued to date for FY 2012 (through August 28). Providing training on agreed-upon procedures engagements to all auditors when only a very limited number of the audit staff performs such engagements would not be a responsible use of resources.

Revised  
Finding  
Pages 60-65

Renumbered  
as  
Recommend  
ation 17





# Inspector General Department of Defense

